SPECIAL 160TH ANNIVERSARY ISSUE

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Politics this week

Jun 26th 2003
From The Economist print edition

That elusive ceasefire

A **Palestinian ceasefire** seemed close, though not quite there at mid-week. So was a Palestinian-Israeli agreement under which Israel would withdraw its army from reconquered Gaza and Bethlehem. In the meantime, Israel continued to pursue, and kill, Hamas men in Hebron and Gaza.

See article: So near and yet so far

In **Iraq**, six British military policemen were killed in a town north of Basra. American forces attacked an Iraqi convoy, thought to contain Saddam Hussein and his sons but more probably sheep smugglers, near the border with Syria. America announced plans for a new, slim Iraqi army, and promised monthly sums to many of the ex-soldiers who have been unpaid since the end of the war. Impeding plans for reconstruction, two Iraqi oil pipelines were blown up.

AP

See article: Coalition casualties in Iraq

America used a meeting of the **World Economic Forum** in Jordan to float the prospect of free entry to American markets for Middle Eastern countries ready “to embrace economic liberty and the rule of law”. Jordan, Morocco and Bahrain are front-runners.

See article: Reconstructing Iraq and the Middle East

Delegates from **UNITA**, the former Angolan rebel movement, held a congress in Luanda to elect a leader to succeed Jonas Savimbi, killed in battle last year.

See article: Angola's weakened opposition

The government of Malawi said it had arrested five suspected members of **al-Qaeda**, and handed them over to America. **Yemeni** forces pursued Islamist militants in the south of the country.

Breaking last week's ceasefire, **Liberian** rebels attacked the capital, Monrovia. President Charles Taylor vowed to fight to the finish. Aid workers feared a calamitous battle for the city. Britain urged America to intervene.

Constitutional club

The **European Union's** leaders, meeting near Salonika in Greece, broadly agreed to a European draft constitution previously prepared at a convention chaired by a former French president, Valéry Giscard d'Estaing. They also agreed that five Balkan countries—Albania, Bosnia, Croatia, Macedonia, and the loose union of Serbia and Montenegro—should in due course join the EU.

See article: The dangers of political union in Europe

The EU's farm ministers agreed to a compromise deal to reform the **common agricultural policy**. The Union's farm commissioner, Franz Fischler, was forced to accept more gradual and less radical changes than he had planned.

See article: A genuine breakthrough?

The **EU** and **United States** held an annual summit meeting in Washington. Top of the agenda: repairing transatlantic relations laid low over the war in Iraq.

See article: Trying to get along

France's strikes and demonstrations, which have been bringing the country periodically almost to a halt for more than a month, in protest against pension reforms proposed by Jean-Pierre Raffarin's conservative government, began to fizzle out.

See article: France's battle for reform

Russia's president, **Vladimir Putin**, became his country's first head of state since Tsar Alexander II in 1874 to make a state visit to Britain. Human-rights campaigners urged Tony Blair to scold Mr Putin for Russia's handling of rebel Chechnya.

The last of **Russia's** independent current-affairs television channels, TVS, closed; a sports channel took its place.

See article: Why another Russian TV station has gone

The **Belgian** government said it would scrap a law that would have allowed people from other countries to bring charges of human-rights violations even if the alleged crimes (supposedly committed, for instance, by America's defence secretary, Donald Rumsfeld) had been committed outside Belgium.

See article: Belgium's bungled human-rights law

Following the resignation last week of **Finland's** first female prime minister, Anneli Jaatteenmaki, the country's defence minister, Matti Vanhanen, who also hails from the rural-based Centre Party, was promoted to head the same coalition government.

A long-delayed visit

China was visited by **India's** prime minister for the first time in ten years. Relations between the two countries have been marred by disputes over borders, Tibet and Beijing's ties with Pakistan.

See article: Two systems, one grand rivalry

Pakistan's president, Pervez Musharraf, met George Bush at Camp David and left with promises of $3 billion in aid over five years. The Islamic opposition called Mr Musharraf a “stooge”. Meanwhile, some 2,000 Pakistani troops moved against remnants of the Taliban and al-Qaeda in the country's north-west.

See article: Pakistan's president in America

In **Afghanistan**, President Hamid Karzai ordered the release of two journalists charged with blasphemy after publishing an article critical of Islam. The arrests were denounced by the United Nations and human-rights activists. The two men still face a trial.

Japan, the largest donor of aid to **Myanmar**, suspended assistance in protest at the detention of the opposition leader, Aung San Suu Kyi, held since May 30th. The EU and America agreed to stiffen existing sanctions.

See article: Repression in Myanmar

The World Health Organisation has lifted warnings against travel to Hong Kong and **Beijing** because of SARS; the disease has killed over 800 people. China's capital was the last place still on the WHO's danger list.

After three years of heated debate, **New Zealand** voted to legalise prostitution. Licensed brothels will

have to operate under stiff health, safety and employment guidelines.

Affirming the affirmative

America's Supreme Court upheld the principle of **affirmative action** by ruling that the University of Michigan could use race as a criterion to choose students in the interests of diversity, while rejecting the university's points-based system because it makes race a decisive factor.

See article: The affirmative-action ruling

In **California**, some 376,000 people signed a petition to throw out the state's governor, Gray Davis; 900,000 signatures are required by September to force a “recall” ballot. Senator Dianne Feinstein, and the state's lieutenant-governor, Cruz Bustamante, said they would not replace Mr Davis if he is ejected.

Firefighters battled to control forest fires on Mount Lemmon in Arizona. The fire has destroyed hundreds of homes in the holiday resort of Summerhaven and thousands of acres of woodland.

Reuters

See article: Fires again in the West's forests

Mass resignation

Peru's cabinet resigned en masse, leaving President Alejandro Toledo with the task of concocting a new one while simultaneously raising teachers' wages and trying to cut the deficit. His approval ratings sank to 11%.

See article: Chaos in Peru's government

Horst Köhler, head of the IMF, arrived in **Argentina** to discuss a loan agreement. Néstor Kirchner, the new president, bluntly told him that Argentina would not sign any deal it could not fulfil.

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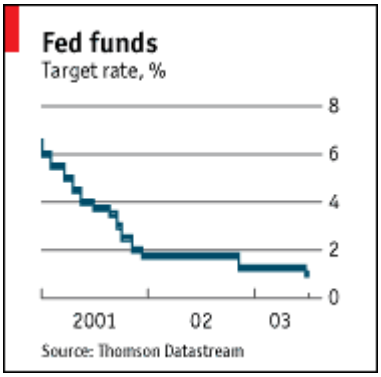
Business this week

Jun 26th 2003
From The Economist print edition

That uncertain feeling



The uncertain state of **America's economy** prompted the Federal Reserve to cut interest rates for the first time this year. The Fed shaved rates by a quarter-point to 1%, the lowest since 1958, in an effort to speed up the sluggish economy and ward off the threat of deflation.

See article: After the Fed's rate cut

Without principal?

WestLB's troubles claimed a first victim. Jürgen Sengera, the German state-owned regional bank's boss, resigned after a regulatory probe of WestLB's controversial principal-finance unit identified a lack of risk control. It required substantial sums to cover potential losses on a deal for the inaptly named Boxclever. Robin Saunders, the unit's boss, could well depart too; the bank may sell the unit, but not yet.

In an unusual twist in the spate of American accounting scandals, **Freddie Mac** revealed that it would restate its earnings upwards. The government-backed mortgage lender may have made up to $4 billion more in profits than it admitted between 2000 and 2002. Three top executives have already departed over the accounting errors.

See article: Time for an overhaul

Goldman Sachs confirmed the healthy recovery that is under way at Wall Street's biggest banks with a sparkling performance in the latest quarter. The elite investment bank's profits rose by 23% over a year ago, to $695m.

HVB's plans to shore up its battered balance sheet took a knock. The German bank cut the target price for a partial sale of its **Bank Austria** subsidiary by 10%. The initial public offering still promises to be Europe's largest so far this year and could raise up to *euro*1.2 billion ($1.4 billion).

AIG, one of the world's biggest insurers, said it would buy General Electric's Japanese insurance business, **GEEdison Life**. GE's American car and home-insurance businesses are included in the price of around $2.2 billion.

After two years of negotiation, the **London Clearing House** and Paris-based **Clearnet** announced a merger. The tie-up of the two European clearers is a further step towards consolidation of Europe's securities markets. The London Stock Exchange was not pleased.

See article: An Anglo-French merger

Entertaining offers

Vivendi Universal's American entertainment interests, put up for sale by the indebted media giant, reportedly attracted four bidders. Marvin Davis, an oil tycoon, and Edgar Bronfman, a former owner, bid for the film, music and TV businesses. Liberty Media's offer excludes the music arm. MGM wants the film library. NBC merely expressed interest; Viacom could yet bid. Vivendi hopes to raise $15 billion or more.

Two of America's biggest biotech firms got together. **Idec Pharmaceuticals** announced that it would acquire **Biogen** for shares worth some $6.4 billion. Idec's chairman insisted that the firms were “remarkably complementary”. Investors agreed; shares in both companies fell by just over 5%.

Advanced Micro Devices blamed its latest setback on SARS. The world's second-biggest chipmaker said that revenue in the second quarter could fall 14% short of target because phone and computer sales in Asia had suffered.

Repairing Fiat

Fiat unveiled its latest restructuring package. The ailing Italian conglomerate will cut 12,300 jobs—mostly outside Italy—and hopes to raise *euro*1.8 billion ($2.1 billion) by issuing new shares in an effort to restore the firm to profitability.

Heineken's shares plunged after it said that profits would not grow in the first half of the year. The Dutch brewing giant blamed the usual suspects: war in Iraq, economic slowdown and SARS, and also a new one: bad weather in America and Europe.

Unilever added to the gloom in the Netherlands. Shares in the Anglo-Dutch consumer-goods giant tumbled after it revealed that sales would not match its previous forecast for the year. Among the factors responsible: SARS.

Swiss miss

Swiss, the airline formed from the carcass of Swissair last year, seems to be heading the same way as its defunct forerunner. Despite getting a huge cash hand-out from Switzerland's government on its formation, Swiss said that it would lay off a third of its workforce—around 3,000 employees—and cut operations by a similar amount. And it asked for another SFr500m ($377m) to avoid bankruptcy.

Congo's **Hewa Bora Airways** angrily denied rumours put about by rivals that it was about to axe its service between Brussels and Kinshasa, citing a local maxim: *hujavuka mutoni, usimtukane mamba* (don't insult the crocodile if you haven't crossed the river).

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Anniversary reflections

Capitalism and democracy

Jun 26th 2003
From The Economist print edition

The Economist has been advocating economic liberty since 1843. We still think we are right

THE magazine you are reading was founded 160 years ago this summer by a Scottish businessman named James Wilson. From the start the chief purpose of the enterprise was to press the case for liberty—and especially for economic liberty, an essential and inseparable, though chronically neglected, part of the broader kind. Writing in 1843, Wilson might have been depressed to know that the cause he advanced would still need defending at the dawn of the 21st century. And he might have been not just depressed by this but also astonished, had he known what the intervening 20th century would show the world about freedom and its enemies. Yet here we are. Surprisingly, *The Economist* is still in business. Unfortunately, it still has its work cut out.

Presumed guilty

When you consider what liberal capitalism has achieved over the past century and a half, not to mention the record of its rivals, the fact that its virtues and its very legitimacy remain so contested is surely remarkable. Avowed anti-globalists are not the issue here: the marchers and window-smashers are not the only, and not the most important, sceptics of the liberal order. Markets continue to function under a surprisingly widespread presumption of guilt. People ask, how could billions of disconnected selfish interactions ever yield an outcome that is collectively right? Adam Smith answered that question roughly 70 years before Wilson piped up, but those who believe what he said are regarded by many fair-minded people as slightly mad. All governments, therefore, work under a corresponding presumption of action. Is some state of affairs not for the best, in the best of all possible worlds? Well, that is just not acceptable: governments had better do something.

The culture that so reluctantly supports modern capitalism tends not merely to accentuate the negative but to obliterate the positive: otherwise, passive anti-capitalism of the kind just described could not have survived so well. Over the past 160 years, the world made hitherto unimaginable progress in human welfare, however you measure it. Yet nowadays, never has so much seemed so bad to so many.

Short-term problems are usually exaggerated. Undeniably, the world economy just now looks especially fragile. The consequences of the burst bubbles of the 1990s have not yet been worked through. Deflation is a risk: in Japan it is a fact, and in Germany close to becoming so. This makes orthodox economic remedies difficult to use (see article). It is worrying—but this is no terminal systemic crisis.

Long-term success, on the other hand, is turned upside-down. For astounding improvements in life expectancy, read population time-bomb. For unparalleled advances in prosperity, read rape of the planet.

For eradication of poverty (as once defined) in the industrialised countries, read widening North-South gap. Show us an economic miracle, and we will show you the failure of capitalism.

While these attitudes prevail, we make no apology for reminding readers that liberal capitalism has been a stunning success, or for celebrating occasional setbacks to blundering statism, or for calling as we often do for further advances in economic liberty. All this is correct—as well as being, we are relieved to see, a sustainable line of business. But we acknowledge that beating back grossly misplaced fears about where capitalism is leading is not enough. For one thing, the prominent anti-capitalist spokesmen make it too easy. Dwelling too long on their bogus concerns is apt to rot the intellect. More important, liberal capitalism as practised in the West today does actually have some defects. Orthodox anti-capitalists are too intent on root-and-branch repudiation to draw attention to the far narrower, yet still important, issues that warrant action.

To mark our anniversary, we publish this week a survey by the editor: “Capitalism and democracy” (see article). It argues, among other things, that the main dangers to the success of capitalism are the very people who would consider themselves its most ardent advocates: the bosses of companies, the owners of companies, and the politicians who tirelessly insist that they are “pro-business”. At the intersection of these groups lies most of what is wrong with capitalism, and the best opportunties to make that system even more successful than it has been thus far.

Many of the corporate scandals that America, especially, has endured in recent years reflect outright criminality. A lawful order knows what to do with criminals, and pro-business politicians are in truth militantly anti-capitalist if they flinch from cracking down on bosses' crimes. The other great ongoing scandal is not a matter of law-breaking: it is that bosses have grown accustomed to rewarding themselves like owners, though bearing few risks of ownership—while the real owners, shareholders in the companies concerned, have let them get on with it. Pro-business politicians who regard this vacuum of accountable control as a private matter of no wider concern are doing capitalism a grave disservice. A system that gives a charter to brazen unchecked greed is a system in peril.

Know thy enemy

Economic liberalism, much like political liberalism, puts great weight on checks and balances, on limits to power and hence to abuses of power. In economics, the most potent checking force bar none is competition. Bosses, shareholders and pro-business politicians all loathe it. They stand to gain, in one way or another, from conspiring to gull the public into regarding competition as a threat to the greater good, rather than to themselves. This is the context in which to think of free trade, an obsession of ours since we started. Liberal trade is nothing but enhanced competition. Anti-globalists have the logic exactly backwards. Far from empowering global fat cats, free trade holds corporate power in check and assaults the excess profits that protectionism, courtesy of pro-business politicians, gouges from the public.

Free trade is where we came in. It is hard work but steady. On present trends, we expect to be campaigning on the subject for the next 160 years.

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Israel and Palestine

That elusive ceasefire

Jun 26th 2003
From The Economist print edition

What a difference an American president can make. Or can he?

Get article background

EPA

FOR three years now, ever since the failure of Bill Clinton's Camp David peace summit of 2000, Israelis and Palestinians have been murdering one another in Israel, the West Bank and Gaza. The Palestinians call their murders an *intifada*, though unlike the first, unarmed, uprising of the 1980s, this one fast deteriorated into a campaign of atrocities against civilians. The Israelis call their murders self-defence, though Israel's so-called “targeted killings” of Palestinian gunmen and bomb-makers have killed many innocent Palestinians as well. The hatred has gone so deep that even seasoned diplomats had come to despair of staunching the violence. On taking office at the beginning of 2001, George Bush took one look at the charnel house and decided, more or less, to steer clear.

Until Iraq, that is. Since his victory against Saddam Hussein, Mr Bush has pinned much of his own reputation on a fresh attempt to make peace. His Aqaba summit with Ariel Sharon and the Palestinians' new prime minister, Mahmoud Abbas (also known as Abu Mazen), breathed new energy into the “road map”, a hitherto implausible plan to bring about the birth of an independent Palestinian state alongside Israel by 2005. At once, new violence dashed the new hope. Accusing Mr Abbas of yielding too much, the extreme Palestinian groups—Hamas, Islamic Jihad and the al-Aqsa Martyrs Brigade—rejected the map and said they would fight on. But now, perhaps, they have changed their minds. Though the details remained unclear as *The Economist* went to press, they were said to be on the point of announcing some sort of ceasefire.

A ceasefire would be a wondrous thing, opening the way for Mr Abbas to rebuild the Palestinian Authority and for Mr Sharon to withdraw Israel's army from the areas it has reoccupied since the *intifada*. The road map says these moves should coincide with a freeze on Jewish settlement and pave the way for the “possible creation of an independent Palestinian state with provisional borders”. The next phase, planned for 2004-05 once the provisional state was up and running, would be a conference to draw borders and settle the fate of the refugees, Jerusalem and the Jewish settlements.

But even if a ceasefire came, would it last? First reports say Hamas and its kin are offering a conditional ceasefire for three months. Yet the road map calls for an unconditional ceasefire. The road map says the Palestinian Authority must dismantle the “capabilities and infrastructure” of the terrorist organisations and confiscate illegal weapons. Yet Mr Abbas says he has neither the desire nor the wherewithal to launch a civil war against Hamas and its fellows. Oh, and then there's the detail that neither Hamas nor Islamic Jihad accepts the idea of two states at the heart of the road map. Their formal aim remains the elimination of Israel (though the Jews, or some of them, may be able to remain, under Palestinian rule). Given this, it is not altogether surprising that Israel accuses Hamas of seeking a ceasefire solely in order to regroup for the next round.

Israel has a credibility problem of its own. Mr Sharon says he is all for two states. But is he? He shows no sign freezing Jewish settlement in the areas where the new Palestine is expected to arise. Nor has he desisted from targeted killings, some of which coincide eerily with moments when the extremist organisations say they are poised to cease fire. Mr Bush has got things moving in Palestine. But if enough Israelis and Palestinians continue to reject the simple principle of land for peace, even an American president will fail to get his way.

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Affirmative action

The wrong decision, poorly made

Jun 26th 2003
From The Economist print edition

The Supreme Court has made America's crazy racial-preference rules crazier still

Get article background

AP

MANY Americans breathed a sigh of relief about this week's ruling by the Supreme Court on “affirmative action”. In a 5-4 ruling, the court decided that universities (and by extension companies and the armed forces) can use race as a criterion when they choose which people they let in (see article). Citing the importance of racial diversity, the court argued that giving preference to “disadvantaged minorities” was in the national interest. On the other hand, in a 6-3 decision, the justices struck down a specific points-scoring system used by the University of Michigan because it made race “a decisive factor”. The compromise has been welcomed by George Bush, various Democratic presidential candidates, the Pentagon and several large companies.

Alas, a popular decision is not necessarily a correct one. In this case the decision seems doubly incorrect—wrong in principle and wrong in execution. This is not the pragmatic solution that takes race out of the equation.

The difference between Peoria and Pretoria

The principle part of the argument is simple enough. Affirmative action, no less than any other form of discrimination, is a bad idea which for a brief time made some sense. In the 1960s it was right to set up programmes to help black Americans redress years of discrimination. Now, 40 years after the Civil Rights Act, the idea of reparation no longer makes sense. The Supreme Court admits this. Hence the new rationale of diversity. Again, this is certainly in America's national interest. But it is a colossal jump from extending help to people who happen to be members of minorities to allowing laws that discriminate in favour of people on the basis of their skin.

For that in the end is what affirmative action is: judging people by their colour. The great tragedy of the struggle to get rid of this anachronism in America—as opposed to, say, in South Africa under apartheid or in Malaysia (which is now phasing out its affirmative-action programme)—is that it has been portrayed as a conservative cause. In fact, treating each applicant for a job or a university place as an individual goes to the heart of liberalism. The white and Asian students who were denied places at the University of Michigan on the basis of their colour were treated illiberally.

Ah, reply the defenders of affirmative action, you are being simplistic. Which in one way is true: principles this basic do tend to be simple. But the charge of neglecting important complications anyway needs to be hurled back at advocates of affirmative action. If racial preferences have any logic at all, it is in two-tone countries with a clear and racially defined overclass and underclass. One could make a good case that America 40 years ago fitted that description; today it is a far more complicated place.

Blacks, the first target of affirmative action, are not even the biggest minority any longer; Latinos are. The fastest-growing group of Americans is of people who say they belong to more than one race. Is a Latino-Asian more in need of affirmative action than a black Pacific Islander who is half native-American? And should whites count as a minority, which they are already in Los Angeles? It is hardly surprising that

the University of California dropped this nonsense.

In their ruling, the majority justices repeatedly see diversity solely in terms of race. But two middle-class kids from Boulder, Colorado, one Asian and one Latino, might have far more in common than either would with, say, a poor white southerner. Similarly, the same justices think that America should socially engineer a multicoloured elite so that America's leaders can be seen to be legitimate. It does not seem to occur to them that an elite which has been socially engineered would, by virtue of that fact, seem deeply illegitimate to many people. And rightly so.

Now for the second big problem: execution. Remember that the Supreme Court also struck down the most explicit version of affirmative action, Michigan's point-scoring system. This may have been ghastly, but, like the “scientific” systems that South Africa once invented for grading whiteness, it had the virtue of being clear. People could see when they were not getting jobs, university places or promotion in the army because of their skin colour. Now affirmative action will go underground. It will be like one of those old clubs that had no rules banning Jews; they just didn't seem to have any. Opacity will please nobody but lawyers and rabble-rousers.

That old technicolour magic

Above all, race-based affirmative action will continue to give America an excuse to run away from dealing with a far more pressing issue that really is about fairness: the condition of the nation's public schools. In America, the gap between rich suburban high schools and poor inner-city ones is remarkable and disgraceful. Addressing the problem means recognising that it has more to do with class than with race. The children of the (fast-growing) black and Latino middle classes go to much better schools than poor white Afghan and Albanian refugee kids who have just arrived in the Bronx.

The justices had a chance this week to draw a line under a once-successful experiment, and to begin the long process of removing race from American law. In most civilised countries, judging somebody on the basis of their race is illegal; but not in the world's most diverse country, where race is getting ever harder to define. Looking at this week's judgment, George Orwell would not have known whether to laugh or cry; but he would certainly have started writing.

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Islam and Africa

It could be worse

Jun 26th 2003
From The Economist print edition

Radicalism is on the rise, but most black African Muslims remain admirably moderate

Get article background

Corbis

ON PAPER, sub-Saharan Africa has what it takes to become a breeding ground for international terrorism. The continent has a lot of oppressive governments, a sprinkling of chaotic "failed states" and millions of Muslims, many of whom resent the West's military, economic and cultural hegemony. But can you name a single black African terrorist? Probably not, unless you count those, such as Robert Mugabe, who terrorise only their own people, and for secular ends. Radical Islamism, which has had such an explosive effect in the Middle East, has failed to catch fire below the Sahara (see article).

The television news can give a different impression. This week has seen a tiff over a shipload of explosives bound for Sudan, five al-Qaeda suspects collared in Malawi, four men charged for their alleged role in a suicide attack in Kenya, and a ban on flights between Kenya and Somalia, for fear that terrorists lurking in the latter might infiltrate the former.

It sounds as if Osama bin Laden's platoons were furiously active in Africa. They probably are, but this does not mean that many black Africans agree with Mr bin Laden's aims, let alone his means. In fact, hardly any do. Islam is both popular and powerful south of the Sahara. Many Africans regard themselves as Muslims first and Nigerians or Senegalese second. But they tend to practise their faith with moderation.

Most African Muslim women dress modestly, but few feel the need to cover every last inch of skin. The more extreme Islamic punishments, such as flogging and stoning, are extremely rare. Alcohol is freely available in almost all countries south of the Sahara, and quite a few Muslims sneak an occasional swig. Syncretism is common, and doctrinal rigidity rare. Many African Muslims continue to observe traditional pagan ceremonies, which upset the morality police in Sudan, but are tolerated everywhere else.

Spats between African Muslims and non-Muslims are common, and sometimes bloody, but for the most part believers and unbelievers rub along well enough. Africa is plagued by civil wars, but these tend to be about local, practical matters such as who gets to control a country's oil wells or cocoa plantations. Few Africans resort to violence for religious reasons.

In recent years, a number of Islamic schools, many buoyed by Saudi funds, have been trying to spread a more a radical form of Islam in Africa. America's conquest of Iraq and support for Israel, which infuriate many African Muslims, doubtless fuel extremism somewhat. But hardly any Africans are signing up for the global *jihad*.

Attempts to impose Islamic states in Sudan and northern Nigeria are gradually fizzling out for lack of popular support. Fears that Somalia would replace Afghanistan as al-Qaeda's main stronghold have proven groundless. As a failed state populated almost entirely by Muslims, Somalia seemed to fit the bill. But the warlords there have no religious agenda, so they were always unlikely to embrace a foreign warlord with apocalyptic goals. Some did try to convince America that their local rivals were allied to al-Qaeda, in the hope that the Americans would bomb them, but they were lying.

Why, if extremism has so weak a grip on Africa, have so many of al-Qaeda's atrocities and attempted

atrocities taken place on sub-Saharan soil? It is not because African Muslims are prone to terrorism. Most of the alleged al-Qaeda members arrested in Africa have been outsiders or locals of Arab descent. Rather, it is because Africa is a soft target.

Plentiful arms, porous borders

Since September 11th, western countries have tightened up their security, and the Arab governments of North Africa have cracked down hard on domestic Islamists, jailing some and prompting others to flee south, where security is as lax as the local security forces are poor. In Angola, for example, where air-traffic control systems are a shambles, a large passenger jet went missing in May. Smuggling arms across African borders is laughably easy. In free and easy countries such as Kenya or Tanzania, western targets are plentiful, and the local police lack the skills or resources properly to investigate threats against them. Hence the current jitters in Nairobi, where the American embassy was temporarily closed this week.

What can the West do about terrorism in Africa? Western security services should co-operate more with their African counterparts, sharing intelligence with those they trust and training those who are willing to learn. With vigilance, many, perhaps most, future plots may be foiled. But not all. Africa is a big place, and there many holes for terrorists to hide in.

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European agriculture

Cap it all

Jun 26th 2003
From The Economist print edition

The European Union's farm reforms need to go a lot further and faster

Reuters

Get article background

TO OBSERVERS of the European Union's insane farm policies, the pattern is depressingly familiar. A modest proposal for change is followed by threats from the French and others to veto even that; marathon talks are held that last days, nights and even weeks; and then a much-hyped "breakthrough" waters down the original proposal but is lauded on all sides as a truly radical reform. In the early hours of June 26th, bleary-eyed European farm ministers duly trumpeted their agreement to the biggest shake-up of their notorious common agricultural policy (CAP) since its inception.

As always with the CAP, the devil is in the details, and it will take time for the European Commission and national governments to work out precisely how these will now change (see article). But several points are immediately clear. One is that, as France and Germany agreed in a bilateral stitch-up last autumn, there will be no change in the size of the CAP budget, which at some *euro*50 billion ($58 billion) a year will continue to take up nearly half of all EU spending. The second is that cereal prices, which the commission had proposed should be cut by 5%, will remain unchanged. A third is that France has secured agreement that it can put off applying the new terms of the CAP for two years, until 2007, even though other countries can bring in the rules in 2005 if they wish (precisely how this can be made compatible with the free movement of farm products inside the European single market remains fuzzy).

The worst dilution of the commission's original plan, however, is that the link between subsidy and production is only partially severed. The most damaging feature of the CAP is not that it shovels ludicrous amounts of money down the throats of often well-off farmers—if Europe's hard-pressed taxpayers are willing to stomach this, that is their problem. Rather, it is that the money is tied to production, with surpluses dumped on world markets via the payment of export subsidies. The commission had proposed to break this link, paying farmers instead for caring for the countryside. But, in a sop to large farmers in France and elsewhere, EU farm ministers have chosen to prolong many production-linked subsidies.

That will imply also keeping the system of export subsidies. The sufferers are mainly developing countries, many of whose economies depend heavily on agriculture. Not only will their exports to rich-country markets still be heavily obstructed; even their domestic markets will continue to be distorted by the dumping of EU surpluses. That is why the rest of the world insisted that the Doha round of trade talks should aim to phase out all farm-export subsidies. For most countries, indeed, this is the biggest single objective of the round.

The Doha talks are already way behind schedule, mainly because everybody was waiting to see if the Europeans were serious about CAP reform. By keeping in place both production-linked support and export subsidies, the EU has shown that it is not. Unless it can come up with a more genuinely radical reform before the next ministerial meeting to review the Doha round, which takes place in Cancun in September, the EU will doom the round to fail. The effect of that on the world economy—and especially on the biggest trader of all, the European Union—would be grim indeed.

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Letters

Jun 26th 2003
From The Economist print edition

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Constitutional questions

SIR – Why was the draft constitution for the European Union so much better received by the European Council than by *The Economist* ("Where to file it", June 21st)? Perhaps because Europe's leaders, unlike yours, understand the need to balance efficiency and democracy, equality of states and of citizens, the intergovernmental and the *communautaire*. Perhaps because they, unlike you, understand the stabilising clarification of the Union's powers, classified in part I and precisely defined in part III of the draft, and the rationalisation of its means of using them (six, rather than the current 15, instruments). Perhaps because they spotted the significance of the proposed new obligations to inform and involve national parliaments, so entrenching subsidiarity. Perhaps because their concerns are with practice not theory: they want a Union of 25 that works, and their positive reactions to the convention's proposals for making Council, Commission and Parliament work better, avoiding zero-sum-game rivalry, were rooted in the real world.

Some in the European Council were ready to sign up to the convention's synthesis straight away: all found it a good basis for the autumn intergovernmental negotiations. Politics is the art of the possible: the convention tested simplistic black/white, all/nothing, federal/confederal solutions and found consensus on them *im*possible. Maybe your carping leader-writer should condescend to leave his ivory tower and look more closely at the text—or at the excellent coverage of it elsewhere in your pages.

SIR John Kerr
Secretary-general
The European Convention
Brussels

Union gap

SIR – Unions targeting shareholders through their pension funds is not exactly a new idea ("Déjà vu", June 7th). It is what our "Invest in Freedom" campaign has been doing since 1996, and many unions in Britain have since joined up. But to say unions should stop protesting and stick to giving legal advice to workers underplays their importance as agents of social change. Trade unions are good social partners precisely because they are on the streets. In an era of global business, thinking, acting and protesting about the universal issues that affect workers is essential for their continued survival.

Louise Richards
Chief executive
War on Want
London

SIR – You are right that unions are essentially service providers who have very little service to provide their members. There are additional factors for the decline of unions, at least in the United States. First, with the support and leadership of unions in some cases, the laws of the country have changed to provide many of the protections once provided by unions.

Second, by providing a common voice, unions have facilitated many of the concessions sought by employers. Current union members in industries where there have been widespread concessions to employers must be wondering why they are paying dues to an institution that is giving back compensation and benefits they have worked for years to obtain.

Jim Wright
Greenville, South Carolina

Return to the marshes?

SIR – Your article on the marsh Arabs rightly documents their appalling catalogue of suffering ("Do they want to go back in time?", June 7th). It is misguided, however, to say that only "a tenacious few" continue to live in the marshlands. With the fall of Saddam Hussein, the AMAR International Foundation has been able to carry out a full public-health survey in the region. At least 45,000 marsh Arabs remain, fighting against the odds to grow food and survive in almost impossible conditions. Many more are in towns bordering the devastated marshlands.

A team of scientists sponsored by USAID is working with AMAR to assess the longer-term undertaking of reversing this catastrophe. It is heartening that so many marsh Arabs remain, but the scale of the task ahead means that they need all the help we can possibly give.

Baroness Nicholson, MEP
Chair
AMAR International Foundation
London

By George

SIR – In your article on George Bush's travels you claim that it was Lord Acton who said "I called the New World into existence to redress the balance of the old" ("Putting the world back together again", June 7th). In fact, it was George Canning, Britain's prime minister briefly in 1827, exercising his bragging rights after the Monroe Doctrine, etc. George following the example of George, in short.

Richard Lyman
Palo Alto, California

The family business

SIR – As an MBA who left a career in economic research to care for my two young children, I can tell you why more women do not pursue the qualification ("Men's work?", June 14th). Business schools and the careers to which they lead mould one to be self-promoting, analytical, decisive and ambitious. Motherhood requires that one be self-deprecating, intuitive, patient and tied down.

I have had to develop hastily the skills for motherhood that I had repressed in order to succeed in the business world and now resent having spent so much time and energy developing exactly the opposite of the talents I need to do what I consider the most important job of my life. For business schools to attract women they would need to change the very nature of business itself.

Barbara Ross Epp
Port Washington, New York

SIR – One reason there are not more women in MBA programmes is that the average age of students is around the late 20s because business schools require that students have some experience of work. An ambitious young woman may want both an MBA and also a family. Finding the right man and having children first may make it difficult to spend the time and money to go back to school later on. It could also prove a disadvantage to gaining work experience compared with other applicants.

Alternatively, go to school before starting a family, graduate around the age of 30 with a staggering amount of debt and work for several years to make the qualification pay. The hiatus caused by starting a family at this stage could then prove a setback professionally, diminishing the return on investment. Small wonder that women who are good enough with numbers to consider going to business school frequently decide not to apply.

Nissa Alexandrov
Ashburn, Virginia

Wedding bills

SIR – I cannot agree that a large investment in a wedding may result in a greater commitment to making the post-nuptial relationship work ("For poorer", June 14th). As soon as the last wedding guest leaves, the whole tiresome event represents a sunk cost and should have no subsequent influence over the marriage-venture decision.

Stuart King
London

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World economy

Breaking the deflationary spell

Jun 26th 2003
From The Economist print edition

This week's American rate cut will not provide a magic cure that revives the ailing world economy

WITH a masterful flick of his wand, our bespectacled hero vanquishes the evil forces that threaten the world. Not Harry Potter, but Alan Greenspan, the owlish chairman of America's Federal Reserve, whom many on Wall Street believe to be an even more powerful wizard. On June 25th the Fed, seeking to ward off deflation, cut interest rates by a quarter-point to 1.0%, their lowest level in 45 years. In anticipation of such wizardry, investors had already pushed American share prices up by more than 20% above their mid-March lows. Share prices dipped after the rate cut as some investors, hoping for a half-point cut, were disappointed. But the markets still seem to believe that the Fed can not only see off deflation, but also return America to a path of robust economic growth. Unfortunately, this hope is more hogwash than Hogwarts.

The market rally is built on fragile foundations. Indeed, the price/earnings ratio for the S&P 500 is now 33 (based on past profits), higher than at the market's peak in March 2000. Over the past three years America's economy has received perhaps its biggest monetary and fiscal stimulus in history. A budget surplus of 1.4% of GDP in 2000 has turned into an estimated deficit of 4.6% of GDP this year. Short-term interest rates have been cut 13 times, from 6.5% at the start of 2001. Long-term bond yields have also tumbled. Given all this, the economy's below-trend growth for the third year running suggests that policy weapons may have lost some of their power. Will this week's rate cut make a difference?

In the first half of 2003, America's GDP grew at an annual average rate of about 1.5%. Many economists predict that growth will rebound to 3.5-4% in the second half. The Fed's latest cut is simply insurance against the risk of deflation. America's core inflation rate (excluding food and energy) has fallen from 2.6% in January 2002 to 1.6% in May. On the surface, May's figures suggested that the risk of deflation was fading: core inflation edged up. But the proportion of individual prices in the consumer-price index that fell over the past 12 months rose to a new high. According to Dresdner Kleinwort Wasserstein, the 12-month rise in the underlying consumer-price index, excluding non-discretionary housing and health-care costs, fell to an all-time low of under 0.4%. A similar measure gave early warning of deflation in Japan.

Some economists argue that America is sure to escape deflation so long as it avoids another recession. They may be wrong. Inflation depends not on the rate of growth but on the level of output relative to potential, ie, the output gap. Historically there has been a close relationship between the output gap and the direction of

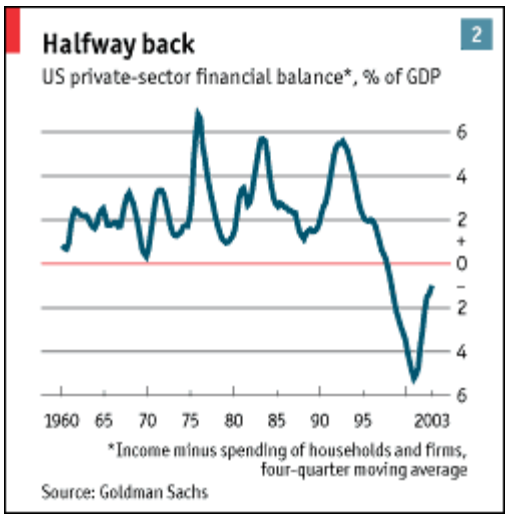
change in inflation. If, as now, the output gap is negative (ie, actual output is below potential) inflation falls; if the gap is positive, inflation rises (see chart 1). Even if America's growth returns to its trend rate of just over 3% a year, the output gap (now about 2% of GDP) will remain large for a couple more years; so inflation will keep falling. To be sure of preventing deflation, America needs to grow faster than trend.

Forecasters have been consistently over-optimistic. In March 2002 *The Economist*'s poll of forecasters offered an average prediction for America's GDP growth this year of 3.6%; that has since been trimmed to 2.2%. That shortfall is popularly blamed on the war in Iraq, which dented business and consumer confidence. The Conference Board's index of consumer confidence has improved since the war ended in April, albeit by less than had been hoped. Consumers are fretful about other things besides war and terrorism, notably the dire state of America's jobs market.

Hubble, bubble

The consensus view that America's growth will now rebound to above trend for a few years is based on the belief that America's economy is fundamentally sound, so that the recent massive monetary and fiscal stimulus will spur it to grow faster. Yet “sound” is an odd word to choose to describe an economy with too much debt, too little saving and an unsustainable current-account deficit.

America's bubble in the late 1990s created excesses that still need to be purged before the economy can resume sustained vigorous growth. The best measure of those excesses is the private-sector financial balance (see chart 2). In the 40 years up to 1997 America's private sector was always a net saver, meaning that total income of households and firms was greater than their spending. Net private saving averaged 2.6% of GDP. But the bubble encouraged a massive boom in borrowing and spending, pushing the private sector into a net deficit of 5% of GDP in 2000. That has since been trimmed. Even so, in the first quarter of 2003 the private sector was running a deficit of more than 1% of GDP. That means it still has a long way to go to restore its financial health.



Households have done much less than firms to repair their balance sheets. The main reason why they could delay this adjustment is that they have been able to borrow against the rising value of their homes. According to Merrill Lynch, over the past six months household debt has increased at its fastest pace for 17 years. The ratio of debt to household income has risen to 111%, up from 102% in 2001.

House prices now look overvalued by past standards. Most economists, including Mr Greenspan, dismiss talk of a housing bubble. But suppose house prices were to stabilise at their current level, rather than actually to fall: even if interest rates stayed low, the scope for further home-equity withdrawal would diminish sharply. So long as interest rates are falling, households can increase debt without any rise in debt service. But once rates hit bottom—and they must be near that in America—the pace of borrowing needs to slow if debt-servicing costs are not to explode. Even with today's historically low interest rates, household debt service is close to a record high as a percentage of disposable income. If new borrowing slows sharply, so will consumer spending, dragging GDP growth back below trend.

Jan Hatzius, an economist at Goldman Sachs, reckons that the recent decline in short- and long-term interest rates, along with the boost to wealth from rising share prices, will again postpone the necessary adjustment of household balance sheets. But it has to occur eventually. At some point households need to save more and spend less. Mr Hatzius concludes that GDP growth will falter again by around the middle of next year.

Companies have done more than households to cut costs and reduce new borrowing. But their

outstanding debts still loom large, and capacity utilisation remains low, so there is unlikely to be another investment boom in the near future. Weak pricing power is also holding back profits. Total profits across the economy, as measured in the national accounts, rose at an annual rate of only 4% in the first quarter. The recent surge in share prices appears to assume that profits will grow at a strapping double-digit pace over the next year, but that will be hard if inflation continues to slide.

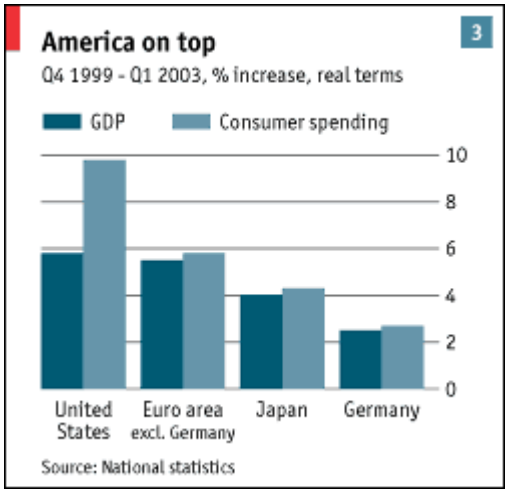
America's escape route

One reason for hoping that America will avoid deflation is a weaker dollar, which will support exports and boost import prices. But devaluation will merely serve to export deflationary pressure to economies that already look vulnerable. Deflation is a global concern. Nominal GDP growth in the G7 rich economies has increased at an annual pace of only 2% over the past two quarters.

Since its bubble burst in 2000, America's real GDP growth has remained faster than that in the euro area and Japan. American consumer spending has outpaced the rest by an even bigger margin, growing at an annual rate of 3%, compared with 0.8% in Germany and 1.3% in Japan. Europe is on the brink of recession. *The Economist*'s poll of forecasters has reduced its GDP growth prediction for the euro area in 2003 to 0.8%, from 2.8% a year ago.

Germany is already back in recession. Its growth over the past three years has been even slower than Japan's, and it is tipped to see virtually no growth this year, compared with 0.9% in Japan. A research paper by the IMF recently warned of a high risk that deflation could soon emerge in Germany. Preliminary figures suggest that Germany's inflation rate rose to 1.0% in June, but its core rate is still falling.

The problem for Germany is that interest rates are set by the European Central Bank (ECB). Because Germany has lower inflation than the rest of the euro area, real interest rates are higher in Germany, even though it has by far the weakest economy. Indeed, growth in the euro area excluding Germany has been virtually the same as in the United States over the past three years (see chart 3). Critics of the euro area who focus only on Germany therefore tend to have an overly pessimistic view.



Throughout the euro area, exports are being squeezed by the rise in the euro, which has risen by about 15% in trade-weighted terms since the start of 2002. The euro is now above most estimates of fair value against the dollar, but it could well climb further. To correct America's massive current-account deficit, the dollar needs to become cheaper still; because many of its biggest trading partners, such as Japan and China, are resisting a rise in their currencies, this means it will have to fall further against the euro. Several forecasters now suggest that the euro could hit $1.40 by the end of next year.

A falling dollar need not export deflation to Europe, so long as the ECB offsets the impact of currency appreciation with lower interest rates. Later this year, Jean-Claude Trichet is to take over as the ECB's new president. The Frenchman is a better communicator than the Dutch incumbent, Wim Duisenburg, but it is not obvious that he will push for any broad softening of policy. The ECB likes to argue that nobody worries about deflation in a single state of the United States, so why should deflation matter in Germany? The answer is that Germany accounts for 30% of the euro-area economy, so there is a bigger risk that it could drag the rest down. The other big difference is that there is more labour mobility between states in America, and also larger fiscal transfers from central to state governments, which makes it easier for depressed states to recover.

Most economists reckon that inflation in the euro area will fall faster than the ECB expects. Dresdner Kleinwort Wasserstein forecasts that inflation could be below 0.5% in the second half of 2004 (down from 1.9% now). It concludes that interest rates will be cut to 1% (from today's 2%) by early next year.

Germany is certain again this year to breach the ceiling set by Europe's stability pact for its budget deficit of 3% of GDP. But that is only because the weak economy has depressed tax revenues; German fiscal policy will be acting as a brake on the economy. France and Italy also look likely to overshoot the 3% limit, but not by enough to allow a fiscal easing. Under pressure from weak growth, some governments

are leaning to more fiscal loosening in 2004. There is growing political support in Germany for income-tax cuts to be brought forward a year to January 2004. But Hans Eichel, the finance minister, insists that this must be paid for by cuts in spending or tax breaks, which would offset any economic stimulus.

While Germany stands out, the rest of the euro area is hardly a picture of economic health. New figures this week showed that consumer confidence fell in June in Italy and Belgium to nine- and ten-year lows respectively. In the Netherlands business confidence fell to its lowest level since 1985. This poses a puzzle. Why does the euro area seem weaker than the United States, when its financial imbalances are supposedly more modest? Europeans who had suspected that America's new economy was largely a bubble had longed for the day when they could gloat over America's misfortunes. Instead, they are hurting even more.

One reason is that Europe, too, suffered its excesses, with massive overinvestment in telecoms. In addition, European investors financed much of America's boom and have since suffered big losses. As the dollar falls, those losses will swell. Europe's failure to push faster with its structural reforms has also meant that a drop in demand causes bigger losses in output and jobs than in America. The ECB and the fiscal stability pact have also prevented the euro area benefiting from anything like the sort of stimulus enjoyed in America.

Lessons from Japan

Not only has Japan's economy actually outperformed Germany's in recent years, but in the year to the first quarter official figures suggest that it was the fastest-growing of the G7 economies, with GDP up by 2.6%. The snag is that prices, as measured by the GDP deflator, fell by 3.3%. In other words, Japan's economy continues to shrink in nominal terms, making it harder for firms to work off their excessive debts. The rise in the yen over the past year, though a lot smaller than the rise in the euro, may also damage Japan's recovery.

Since Toshihiko Fukui took over as its new governor in March, the Bank of Japan has shown a bit more flexibility in its policy to try to halt deflation. The central bank has further increased the monetary base and, in an unprecedented move for a central bank, has announced that it will buy corporate debt with the aim of helping smaller firms to obtain loans. However, the bank continues to reject more radical measures to defeat deflation. Worse, the Koizumi government remains set on reducing the budget deficit, which risks snuffing out the recovery and worsening deflation. The best way to restore fiscal health is to end deflation. Faster growth in nominal GDP would help to boost tax revenues and reduce the deficit.

What lessons does Japan hold for America and Europe? The most important was spelled out in a research paper last year by a team of Fed economists. They concluded that Japan's monetary policy in the early 1990s looked appropriate, given forecasts at the time for growth and inflation. In other words, it is wrong to blame the central bank's incompetence for all of Japan's woes; nobody inside or outside the bank had forecast deflation. By the time it arrived it was too late. The lesson is that, when inflation is low and there is the slightest risk of deflation, policymakers should take out insurance by cutting interest rates more than they otherwise would.

The Fed now seems to be following this advice, but it is running out of ammunition. There is little room to push short-term rates lower. Interest rates below 0.75%, say, could risk destabilising the short-term money market, because banks would have less incentive to hold idle cash in short-term deposits. However, the Fed insists that it still has the tools to fight deflation—even if, as officials insist, it is highly unlikely that they will be needed. These “unconventional measures” include large purchases of government bonds to reduce long-term interest rates, intervention to push down the dollar, or buying private securities to push up asset prices.

Nobody knows how effective such measures might be. But at least the Fed is trying to move inflationary expectations in the right direction, by saying that it stands ready to go down this road and publicly sounding confident that it can succeed. In contrast, by saying there is nothing it can do to end deflation, the Bank of Japan merely reinforces the expectation that deflation will persist. The Fed's most effective policy weapon so far has been to reduce bond yields, and thus borrowing costs, simply by airing the possibility of buying government bonds.

The Fed, it seems, will stop at nothing to keep the post-bubble economy afloat. Stephen Roach, chief economist at Morgan Stanley, worries that the Fed has become a “serial bubble blower”. After playing a key role in nurturing the equity bubble of the late 1990s by holding down interest rates, it has since

propped up the economy by fuelling first a property bubble and now a bond bubble. Recessions are normally periods when the excesses of previous booms are purged. The late 1990s boom created some of the worst excesses ever, yet the recession in 2001 was the mildest in history, so many excesses remain. The Fed is wise to guard against the danger of deflation, but this still leaves big concerns about the unbalanced state of the American economy. Even Mr Greenspan's wizardry may not be enough to ensure a sustained healthy recovery.

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Affirmative action

Anyone for a bit of legal fudge?

Jun 26th 2003
From The Economist print edition

AP

The Supreme Court's long-awaited rulings on affirmative action reflect America's continuing ambivalence about race

Get article background

THERE is something curious about a decision that purports to solve a hotly contested public issue, and then wins support from both sides of the debate. The Supreme Court's rulings on two closely watched affirmative-action cases on June 23rd achieved this remarkable feat.

The University of Michigan and its law school had been sued separately by rejected white applicants for using racial preferences to help black American, Latino and American-Indian students gain entry. Though it lost one of the cases, the university's president hailed the decisions as a “tremendous victory”. Strangely, so did President George Bush, whose officials had argued before the court for doing away with both schools' affirmative-action programmes. “I applaud the Supreme Court for recognising the value of diversity on our nation's campuses,” he said in a statement. “Diversity is one of America's greatest strengths.”

Huh? The explanation for these reactions lies less with the Solomon-like wisdom of the court's nine justices—who offered an array of tortuously reasoned views in a blizzard of dissents and concurrences—than with the fact that mainstream America is deeply ambivalent about the whole issue of racial advancement, and wanted some form of compromise.

Polls show that a narrow majority of Americans reluctantly endorse the idea that racial preferences are still necessary to ensure diversity in education and employment in the interests of racial harmony, but they also find the idea of outright racial quotas repugnant. Smart universities, large companies and senior military officers all filed briefs supporting the University of Michigan's use of racial preferences, and have reacted with relief at the court's ruling that these are still legal if not applied too “mechanically”. Adjustments may have to be made to some university-admissions policies and corporate-employment practices, but little more than this.

Despite the broad welcome for the court's rulings, the dispute about affirmative action will continue unabated. The real losers from this week's decisions have been those conservatives who had hoped that

Mr Bush would persuade the court to eliminate all racial preferences, not only in university admissions, but in every area of American life.

Mr Bush's own proposal reeked of political compromise. He proffered a confusing proposal to maintain racial “diversity” through “race-neutral” methods. But other more ideological members of his party will see the court's fudge this week as another reason, on top of abortion, to push for a more conservative Supreme Court should any of the current justices soon retire. A switch of one vote in the current cases might well have made all affirmative-action programmes illegal.

Moreover, the court's decisions are not clear-cut enough to stop a stream of further legal cases testing what it now means by an acceptable approach to affirmative action. In one of the two cases decided this week, *Gratz v Bollinger*, the court ruled 6-3 that the University of Michigan's undergraduate-admissions programme was unconstitutional because its system of awarding points to minority applicants made it too much like a racial quota.

Quotas had been ruled out by the famous 1978 *Bakke* decision which, nevertheless, said that race could be taken into account as a “plus”, although only as one of many other factors. Michigan thought that it had met the *Bakke* requirements. It awards points for various non-academic qualities, including geographic location, athletic prowess and alumni connections, as well as race. But the court's majority opinion, written by Chief Justice William Rehnquist, said that the university's scheme was too broad, and so violated the equal protection of the laws guaranteed by the constitution's Fourteenth Amendment—ie, it was racially discriminatory.

In the other case before the court, *Grutter v Bollinger*, a different majority of justices upheld by a 5-4 majority the admissions programme used by the university's law school, which also takes race into account, but does not use a points system like the undergraduate programme. As so often in closely disputed issues before this court, the key figure was Justice Sandra Day O'Connor, who voted with the majority in both cases, and wrote the majority opinion in the *Grutter* case.

The law-school programme, she explained, is constitutional because it is a “highly individualised, holistic review of each applicant's file”, rather than a rigid formula. The undergraduate points scheme, by contrast, is a “non-individualised, mechanical” system, and so not closely enough tailored to meet the court's strict-scrutiny standard for constitutionally acceptable racial classifications.

From a legal point of view, the biggest advance on the *Bakke* decision of 25 years ago is that Justice O'Connor has managed to persuade a majority of the court that racial diversity, rather than a remedy for past injustices, is a public interest compelling enough to justify exceptions to the constitution's ban on racial discrimination. Back when *Bakke* was decided (in an even more fractured and confusing ruling) only one judge endorsed the diversity argument. This change is the reason why supporters of affirmative action have greeted the *Grutter* opinion with such jubilation.

There is a discernible rationale behind Justice O'Connor's position. In effect, she concedes that affirmative-action schemes are racially discriminatory but argues that they are necessary, at least for a time (she mentions 25 years), to ensure diversity. But such schemes have to inflict the minimum harm on those who lose out—white and Asian Americans. This balancing act between conflicting ideals echoes what Americans tell pollsters they want.

What will the effect be? In the case of college admissions, affirmative action has less practical effect than you might think. Only a fifth of four-year colleges and universities, the most selective, engage in it, according to one reliable estimate. In 2001, 55% of black high-school students and 52% of Latinos went to college—not dramatically lower than the proportion of whites (64%). The real problem for blacks and Latinos is not access to higher education; it is low test scores, which exclude them from the most prestigious institutions.

By contrast, not many whites are damaged by affirmative action. Because the number going to top schools is so much greater than the number of minority Americans, the proportion of white applicants denied entry to university because of affirmative-action policies is tiny.

An upper class for our times

Nevertheless, symbolism itself can matter, especially in top-grade institutions that are training the next generation of American leaders. This is also the main reason why the American armed forces have been

so keen on affirmative action. In her *Grutter* opinion, Justice O'Connor points out that graduates from a handful of the best law schools are massively over-represented in all branches of government. “It is necessary that the path of leadership be visibly open to...every race and ethnicity,” she writes.

Nobody would disagree with that. But in practice Justice O'Connor's compromise will probably force discrimination into the shadows—to become implicit, not explicit. There will be less rather than more transparency in university admissions and employment policies. And that will make such policies harder to monitor for unfairness. More lawsuits can be expected.

In addition, Justice O'Connor's idea that the new regime will be a temporary one seems bizarre. Surely racial diversity will always be a desirable aim in a pluralistic society such as America's? So, unlike remedying past racial injustices, the pursuit of diversity could well be a recipe for permanent racial balancing.

Justice O'Connor denies this, writing that “the court expects that, 25 years from now, the use of racial preferences will no longer be necessary.” This seems a forlorn hope—unless, of course, Americans are so colour-blind by 2028 that they no longer even notice each other's race. That is unlikely, to say the least, and entrenching racial preferences makes it unlikelier still.

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Redistricting Texas

A vote after all

Jun 26th 2003 | AUSTIN
From The Economist print edition

That bill they thought they'd dodged comes back to haunt the Democrats

Get article background

WHEN a band of Texan Democrats fled to Oklahoma in May to kill a redistricting bill, by denying the state's House of Representatives its necessary quorum, it seemed that their foundering party had pulled off a rare victory. Now they are putting the champagne away.

Texas's Republican governor, Rick Perry, has called a special session of the legislature for June 30th to bring the bill to a vote. This time, the House Democrats seem to have decided that another cross-border run would be unseemly. Instead, they are hoping that a dozen of the state's senators will use their more generous rules to save the party from yet another humiliation.

The governor says the special session is needed to undo a court-ordered plan issued in 2001 after a divided legislature failed to reach a decision. “Duly elected officials, not federal judges” should redraw the state's congressional map, he explained. Never mind that the session will cost $1.7m, or that two years ago Mr Perry refused to “expend considerable sums of taxpayer money” on a similar session.

The difference now is that both houses of Texas's legislature, and all its statewide offices, are controlled by Republicans. That leaves one nagging exception: the Democrats have a 17-15 majority of Texas's seats in the national House of Representatives in Washington. The Republicans reckon the redistricting bill could shift as many as six of these seats to their side.

The leader of the Republican majority in the House in Washington, Tom DeLay, who is nicknamed “the Hammer” for his mild-mannered Texan ways, longs to gather this harvest. So, naturally, does the White House.

In the 31-member state Senate, it takes 21 votes to bring up any legislation, so 11 of its 12 Democrats would be enough to block redistricting. Any bill that gets to the Senate floor is sure to get the Republican majority's okay, but it has to get there first. This makes those Democratic senators' votes worth a bundle. Over the past few weeks at least three of them have suggested they are willing to deal. Governor Perry, no stranger to backroom bargaining, has offered money for medical centres in south Texas, home of two of the ditherers.

But Mr Perry is having trouble with one key Republican state senator—Bill Ratliff, of deep east Texas. Mr Ratliff frets that Mr DeLay's redistricting map would “obliterate” his swathe of rural Texas by mixing it in with boring city-dwellers and suburbanites. Karl Rove, George Bush's political right-hand man (and yet another Texan), has politely informed Mr Ratliff that a redistricting bill “could be important to the president” (loose translation: do this, or start measuring yourself up for crutches). Mr Ratliff has replied that he is open to a “reasonable” redrawing of constituency boundaries, whatever that means.

Mr Ratliff thinks the redistricting bill could be settled by a single vote in the Texas Senate in July. One Democrat, Senator Frank Madla of San Antonio, is reported to have said that he might vote to bring up the bill if the legislature, in return, approves of something he yearns for—a bill allowing sales of wine on the internet, an idea the beer-and-liquor boys have bottled up for years. Maybe that champagne wasn't so premature after all.

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The United States and Europe

Making up

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Tensions could be shifting from politics and terrorism to economics

AFP

You Grecians ever seen cameras before?

EVERY year now the United States and the European Union hold a summit. It used to be every six months, but George Bush seems to have stopped that. Why get together just to produce a lot of happy-clappy bromides about how the United States and Europe are "working together to solve the problems of the world"?

One beauty of this week's summit in Washington, DC, was that these bromides should have been impossible to utter. In the wake of the rift over Iraq, transatlantic relations are arguably at their lowest point since the second world war. Americans are still refusing to buy French wine. European newspapers are still portraying the United States as a rogue nation. And at least one senior French minister is still telling his fellow diplomats that the only thing that Americans know how to do is shoot.

So there was something rather magnificent in the way that Costas Simitis, the Greek prime minister and current president of the European Union, and Romano Prodi, the president of the European Commission, held the line at their press conference. Mr Prodi declared ingeniously that it was "a very good meeting because it was a very good meeting atmosphere" before meditating on the virtues of old age. CNN terminated its coverage as soon as it decently could, leaving Americans to ponder another eternal mystery: how could the EU send such extraordinarily boring leaders to the home of the remote control?

Yet behind the scenes both American and European officials were billing the summit as an important piece of repair work. The western alliance is beginning to see eye to eye on what some Americans call "the new security environment" of rogue states, terrorist networks and weapons of mass destruction.

Better than it looks

The most obvious signs of this progress are various new agreements to speed up the extradition of terrorists and improve the investigation of suspect bank accounts. The Americans, who have long whinged about the EU's failure to tackle weapons of mass destruction, were pleasantly surprised by Europe's tougher approach to Iran. The Europeans are willing to scrap a proposed trade deal with Iran if it does not accept inspectors from the International Atomic Energy Agency.

Of course, the Europeans continue to be much keener on fighting the war against terrorism through diplomacy and multilateral institutions than the Americans. And they are also balking at Mr Bush's insistence that they declare Hamas a terrorist organisation. But Mr Bush's people think some recent soul-searching in the EU is leading to a tougher approach.

Last week EU foreign ministers agreed that the use of force to deal with weapons of mass destruction could be envisaged when diplomacy fails. A tough new EU paper on security does not read as if it was written by complacent inhabitants of a "post-historical paradise"—to use the term for Europe coined by one neo-conservative, Robert Kagan. In Washington, Javier Solana, the EU's foreign policy co-ordinator and a former head of NATO, is increasingly seen as hawkish—or as tough as a bearded Spanish socialist can be.

On the economic side of the relationship, there was also good news to report. The summiteers unveiled an “open-skies” agreement to free up flying between the two continents. There was talk of progress on trade. Pascal Lamy and Robert Zoellick, the top European and American trade negotiators, get on much better than Charlene Barshefsky and Leon Brittan did in the Clinton era, and their good relationship has survived serious blows, such as America's decision to impose steel tariffs. Philip Gordon of the Brookings Institution points out that one encouraging message of the summit is that business does go on.

But clouds are gathering. It remains to be seen how Europe's new deal on the common agricultural policy will affect the Doha trade round. Meanwhile, Europe continues to stand by its 1998 moratorium on the import of genetically modified food—a moratorium that supposedly costs American farmers $300m a year in lost corn exports alone.

Mr Bush is off to Africa next month where he will probably argue that Europe's hostility to GM food is helping to worsen famine. And there are no signs that the administration will withdraw the suit against the Europeans' GM-food ban at the WTO. The next set of rows—and of bromides at summits—could be about economics, not politics.

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Judicial corruption

The new Brooklyn dodgers

Jun 26th 2003 | NEW YORK
From The Economist print edition

Democratic politics in the borough is even murkier than you had thought

UNTIL recently, few New Yorkers had heard of Clarence Norman, a local Democratic politician who kept his head quietly down. They are therefore surprised to learn that he is in fact his party's kingmaker in Brooklyn, one of the largest Democratic county organisations in the country—and dismayed to discover that he is a central figure in a big investigation into judicial corruption.

Charles Hynes, the Brooklyn district attorney, launched the investigation into the judges last year. In April, Justice Gerald Garson was indicted on charges of fixing divorce cases in exchange for favours and suspended from New York state's Supreme Court. Now the inquiry has spread much wider, and reaches far beyond alimony payments and who did (or didn't) get the brownstone in Park Slope.

One in ten of all Brooklyn's judges—most of them apparently picked for their jobs by Mr Norman—are said to be under some sort of investigation. Some are alleged to have bought their seats. Others have been accused of taking bribes. Trial verdicts are also being scrutinised.

In effect, Mr Hynes is asking whether Brooklyn's Democratic Party buys and sells judgeships. About ten lawyers, six financial investigators and a dozen detectives are involved in the inquiry. Although it may be months before any indictments are handed out, Mr Norman has reportedly hired a lawyer to defend him. One of his colleagues, a senior member of the borough's judicial-selection committee, resigned last week.

The state's Supreme Court justices are nominated in closed conventions usually controlled by a party boss. Civil courts, which have primary elections, also appear to be under the boss's thumb. A former civil-court judge has claimed that Mr Norman threatened to remove her from the ballot unless she used his expensive campaign consultants. A former housing judge says she was put under pressure to use the same consultants. One Brooklyn judge's father has been accused of spending some $50,000 in the past five years to secure his son's nomination. And so it runs on.

Some politicians, too, seem to have been asked to make large donations to Mr Norman's “political club” in return for his support. The campaign team of the Democrat who ran unsuccessfully for New York's mayorship in 2001, Mark Green, is said to have been strong-armed into forking out almost $250,000.

What puzzles many New Yorkers is why there was any need to raise so much money. Most of the judicial candidates were appointed by the party. Others faced practically uncontested single-party elections in a borough that is overwhelmingly Democratic. Prosecutors want to know where the money went. They may have found some of it: Mr Norman apparently spent $130,000 with a party credit card. They are still looking for the rest.

Polls show that three-quarters of Americans think that judges favour people who give money to political campaigns. The proportion may be higher in Brooklyn. Fern Schair, the head of the Committee for Modern Courts, a legal reform group, thinks there have to be changes not only in the way judges are selected but also in the Democratic Party itself.

The biggest beneficiary of the scandal will be those oxymoronic figures, Brooklyn Republicans, if they can only figure out how to seize the moment. A hint of how they might do it: follow the alimony. New Yorkers can tolerate a lot. But don't play around with a New Yorker's divorce: he, or she, will certainly blow the whistle.

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Seasonal excitement

Coasting

Jun 26th 2003 | DOSWELL, VIRGINIA
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In praise of a great summer tradition

IN 1884, wide-eyed visitors to Coney Island freaked out on America's first rollercoaster, capable of a blistering top speed of 6mph. The amusement-park industry, which now rakes in $9.6 billion a year, has never looked back. These days something like 320m people a year visit these places, taking in all around 900m rides on coasters that go at ever greater speeds.

Last weekend around 750 members of American Coaster Enthusiasts returned to the theme park where their organisation was born 25 years ago: King's Dominion, just outside Richmond off busy Interstate 95. The get-together was a (nearly) round-the-clock celebration of coasters. During the day, members piled into gravity-defying rides such as “Rebel Yell”, a name that celebrates Richmond's Confederate heritage; some dashed down the road to Busch Gardens, a park near Williamsburg erected by the company that brews Budweiser beer. Come the night, they swapped photographs and home-videos of their favourite coasters.

Altogether American Coaster Enthusiasts boasts 8,500 members. The typical fan is about 40 years old and has ridden at least 60 rollercoasters. Two out of three are college graduates, leading what Henry David Thoreau might have described as lives of quiet desperation—until they clamber into a rollercoaster. “There's something about being out of control,” says a 54-year-old librarian from Kalamazoo, Michigan. “When I'm on a rollercoaster, I'm a kid again.” For a Los Angeles pathologist, a ride on a rollercoaster is a release from the pressure of her work. “That's why my hobby isn't chess...I don't want to stress my brain more than I have to.”

Such get-togethers are not unusual. In 1998 in Virginia, a group of married enthusiasts marked their wedding anniversaries aboard a white-knuckle ride called “The Outer Limits”. Women wore veils; operators donned morning suits; a minister performed a brief ceremony.

Coasters now appear just about everywhere. In Las Vegas, for instance, casinos now think coasters will lure families to their gambling dens. Last year, the Stratosphere, a towering casino, tried to get approval for a ride across Las Vegas Boulevard. This week, it unveiled plans for “Project X Sky” which it claims will “play upon people's primal fear of falling.”

Despite occasional injuries and deaths, rollercoasters are relatively safe. The latest figures put the accident rate at just over two per 100,000 visits**.** Howard Fienberg, an analyst of the Statistical Assessment Service, points out that your chances of being involved in a car crash on the way to an amusement park are considerably higher than your chances of having an accident once you're there.

Other people are not so sure. Representative Edward Markey, a Massachusetts Democrat, has long pushed for more federal supervision of rollercoasters and other rides. Last month, after an 11-year-old girl died on a rollercoaster in Illinois (after choking on a sweet), Mr Markey promised to stop “the rollercoaster arms race”, which he says “leads to rides designed to carry children's bodies through space at faster and faster speeds”.

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The fires return

Not just the trees are ablaze

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From The Economist print edition

The fires begin again, and so do the political rows. But why not just thin the forests close to towns?

AP

Get article background

FIREFIGHTERS in Arizona hope that they are at last getting under control a fast-moving forest fire that in its early stages had burned 250 homes in a summer community near Tucson. But the destruction already wrought by the Aspen Fire, as the Arizona blaze is called, has reminded Americans of last year's fire season, among the worst in recent decades.

Last summer 7m acres were burned and $1.6 billion spent in fighting the fires. Three states—Oregon, Colorado and Arizona—had their worst-ever fires, including a monster in Oregon called the Biscuit Fire that burned across half a million acres and cost $150m to fight. This was the dearest single-fire operation in the history of the Forest Service, the agency that manages much of the public timberland in the west.

Whether 2003 will be as bad as 2002 will not be clear for some weeks, the Aspen Fire aside. Although some drought-hit parts of the west got plenty of rain in the spring, large parts of California, Idaho, Montana, Wyoming and Arizona are still in the grip of a drought that has persisted since the late 1990s, creating conditions in which a bolt of lightning—or a careless match, the possible culprit in Arizona—can easily ignite a fire.

Why are fires in the west now bigger and hotter than in the past? That drought is one reason. Another, alas, is the too-successful fire-suppression campaign of the 1940s and 1950s. The firefighting of those days upset the natural order of things. In some cases it allowed the build-up of grasses, shrubs and young trees that formerly had been removed by frequent, mild fires. In others it prevented “stand-replacement” fires (which take out every tree in the forest) so when they finally happened they were often enormous—like the Yellowstone fire in 1988. Vast stretches of western forests—by some estimates 190m acres—now have loads of burnable stuff.

Last August, while visiting southern Oregon at the height of the Biscuit Fire, George Bush announced a “healthy-forests initiative” aimed at reducing the risk of fire. The plan called for, among other things, logging healthy trees to pay for the gritty work of culling excess fuel from crowded forests. It also sought to reduce the ability of environmentalists to file awkward lawsuits. The plan made little immediate progress in a distracted Congress. But Mr Bush went ahead with parts of it anyway, applying through the Department of Interior and the Department of Agriculture schemes such as “stewardship contracting” that give logging companies the right to harvest timber so long as they also do anti-fire thinning.

The president's efforts have now been helped by a bill that passed the House of Representatives in mid-May, pushed by Scott McInnis, a Republican from Colorado. It proposes to spend $420m both to help local governments deal with fire threats and as seed money for “bio-mass” projects that would turn the bits of wood culled from forests into electricity by using them to heat turbine-driving boilers. It also backs the president's desire to cut the number of lawsuits by sharply limiting the period during which opponents of a proposed thinning project (which often looks much like logging) can file a suit. “It's time we let the green hats decide what's best for the forest,” Mr McInnis says, referring to the green-clad Forest Service people. His bill now goes to the Senate.

There are grounds for scepticism, however, about Mr Bush's and Mr McInnis's wish to let the experts solve the problem. A General Accounting Office (GAO) report published a week before the House passed Mr McInnis's bill undermined the contention that environmentalists' lawsuits are gumming up the effort to prevent fires. The GAO said some 95% of the fire-control plans proposed by the Forest Service and other agencies were approved within 90 days. Very few faced legal challenges.

More seriously, although thinning can sometimes help to limit a fire by removing some of the fuel the fire wants, it is not a process that is neat, cheap or necessarily effective. Removing small trees and brushwood from a forest requires heavy machinery or large teams of workers with chainsaws and axes. Taking away the thinned-out material is difficult, and sloppy thinning can increase the risk of fire by leaving dry branches and leaves on the forest floor. Anyway, thinning isn't a one-time deal. To be effective, it must be repeated every four or five years.

The thinner the better

Better, says Randal O'Toole, an Oregon-based economist and a critic of the Forest Service, to do most of the thinning around towns threatened by wildfire. It does not take much to create an effective fire barrier; a ring of space about 200 feet from buildings usually does the trick, and does not cost much. “We don't know where fires will start,” says Sharon Galbreath, director of a group of Arizona greens. “But we do know where towns are.”

The Forest Service is understandably enthusiastic about the proposed new anti-fire rules. These will pump lots of extra dollars into an agency with a budget of $4 billion at a time when institutions such as the National Park Service are all but sitting at park gates with tin cups. But plenty of people besides the usual suspects (the greens, who seem more depressed by things these days than angry) are up in arms. “It's just an excuse to bloat up the Forest Service bureaucracy,” says Mr O'Toole. “The Forest Service has never known what to do about fire.”

Anyway, he says, the proposals ignore the fact that many western forests are bound to burn. Some forests in the south-west and along the Sierra Nevada, dominated by ponderosa pine trees, are evolutionarily adapted to survive frequent fires. Here, thinning may help. But Mr O'Toole says that other forests, such as the lodgepole pine forests common in Wyoming, Montana and elsewhere, are genetically programmed to burn to the ground once a century or so, as happened in Yellowstone in 1988. There, regardless of human efforts, fires will always to be a fact of life.

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Lexington

On the tiger and mad as hell

Jun 26th 2003
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Meet Howard Dean—one part McCain, two parts McGovern, and the last thing the Democrats need

HOWARD DEAN admits that when he decided to run for president even his mother said it was preposterous. He meant nothing to anybody except his fellow Vermonters and a handful of health-care bores. Now, he is the Democrat to watch. The former governor of Vermont (population 610,000) is doing more to shape the Democratic primary than either John Kerry, a senator from Massachusetts (population 6.4m), or Joe Lieberman, who as Al Gore's running mate picked up 51m votes in 2000.

To understand why this is happening you need to understand the state of mind of hard-core Democrats. To put it simply: they're pig-wrestling mad. They're mad about the “stolen” election, mad about tax cuts, mad about John Ashcroft and mad, above all, about the Iraq war. No sooner had Mr Dean sounded his trumpet against that conflict than he had an army at his back.

Mad-as-hell activists love Mr Dean's penchant for attacking the Democratic establishment as being too addicted to Beltway manoeuvring to stand up to the president. He repeatedly condemns his fellow Democrats for peddling Bush Lite on both tax cuts and Iraq. He points out that Bush Lite has produced not centrist triumph but the electoral debacle of 2002. All he needs to do is say, “I'm Howard Dean and I represent the Democratic wing of the Democratic Party,” and the cheers begin.

If this signature line is stolen from the late Paul Wellstone, Mr Dean's persona is purloined from John McCain, that straight-talking Republican. He is selling himself as the embodiment of authenticity: an anti-politician who is not afraid to express outrage. Like Mr McCain, he is making up for his lack of establishment support by tapping the grass-roots. And he is turning his sharp-edged personality into an asset, proof that he is not just another blow-dried mediocrity from the Beltway.

The result is huge enthusiasm. “Howard Dean” bumper stickers are replacing “Peace Now” stickers on the nation's Volvos. An internet site called Meetup.com is generating more interest in Mr Dean than in any other candidate. In the first quarter of this year he raised more money in Cambridge, Massachusetts, and Beverly Hills than Mr Kerry or Mr Lieberman.

Mr Dean is actually rather an odd champion for the party's Democratic wing. As governor of Vermont for 11 years the doctor-turned-politician was a pragmatic New Democrat in the Clinton mould. He resisted irresponsible spending increases, fought with the state's Progressive Party and vigorously upheld the right of Vermonters to carry concealed guns. He even defied a national trend by changing his mind in favour of the death penalty.

He continues to sell himself as a “deficit hawk” and “balanced budget fiend” (the Bush fiscal policy, he says, is modelled on Argentina's). His health-care plan is much more market-driven than the Clinton administration's plan, and much cheaper than Dick Gephardt's ($88 billion compared with $214 billion). His views on the Middle East are pretty close to the Israeli lobby's. He is against medical marijuana laws and the anti-global-warming Kyoto protocol.

So would Mr Dean be able to repackage himself as a centrist if he won the nomination? Hardly. His views on guns count for little compared with his strident opposition to war in Iraq and his determination to

repeal “every dime” of Mr Bush's tax cuts. For good or ill, Mr Dean has decided to climb on the back of the leftist tiger. He cannot climb off without being eaten alive.

The sight of Mr Dean on the tiger's back is striking terror into the party establishment. On Capitol Hill Democrats worry that a Dean candidacy will not only allow Mr Bush to sweep the electoral college but also to cull vulnerable Democrats in the conservative south and the middle-American heartland. What chance has a liberal north-easterner backed by money from Beverly Hills and Harvard Yard of helping the Democrats in vulnerable Senate seats in Arkansas, South Carolina and the two Dakotas?

The Dean campaign is indignant about such arguments. Didn't me-tooism produce the debacle of 2002, they ask? Well, yes. But the only thing more dangerous for the Democrats than Bush Lite is McGovern Extra Strength.

Tyger tyger, burning the right

Liberal populism has invariably proved to be a disaster for the Democrats. Remember Karl Rove's habit during the 2000 election of comparing George Bush with William McKinley? The reason why McKinley was able to usher in 30 years of Republican hegemony was that he was confronted by William Jennings Bryan and his agrarian populism. George McGovern and Walter Mondale led their liberal armies to two of the worst defeats in American history. It is hardly likely that the old-time religion will go down better in the age of global terrorism.

Terry McAuliffe, the Democrats' chairman, deliberately compressed the primary season to scotch insurgencies like this one. Yet Mr Dean easily won the (unofficial) Wisconsin straw poll. He has started advertising on television in Iowa seven months before the caucus. And as the only serious candidate without a full-time job, he has a chance to cultivate the grass-roots. If he comes first or second in Iowa and then defeats Mr Kerry in New Hampshire, he may succeed where Mr McCain failed.

Besides, Mr Dean does not have to win for his party to lose. His insurgency is already tugging other candidates to the left. Hardly a day goes past without the other front-runners producing some new piece of populist rhetoric. This week Mr Gephardt promised that as president he would use executive orders to countermand “any wrong thing that the Supreme Court does”. The problem for the Democrats is not just the man from Vermont but the rank-and-file rage that he embodies. Far too many Democrats are just too angry to think straight at the moment. And far too many would rather go down to glorious defeat than make the irritating compromises necessary for power.

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Crime in Mexico

Wakey wakey!

Jun 26th 2003 | MEXICO CITY
From The Economist print edition

The Mexican government wants a total reform of the country's creaking criminal-justice system

Reuters

Get article background

AS ELECTIONS loom in Mexico, prospective politicians are finding that people care most about crime. Despite the endless proliferation of shiny new specialist police forces, each supposedly less “corrupt” than the last, the truth is that things are getting no better.

So low is Mexicans' faith in the ability of the criminal-justice system to bring any criminal to justice—according to a poll done for a specialist institute on criminology last year—that about four-fifths of victims do not even bother to report the crime. Some 44% of those interviewed said they lived in an atmosphere of some, or great, insecurity, a figure that rises to 83% in Mexico City. This is not only a disastrous state of affairs for the average Mexican, but a big disincentive to foreign investment. The cost of security, especially against kidnapping (a real threat), can be prohibitive.

Since the tinkering of the past ten years has plainly not worked, the government is now proposing, in one package, an unprecedented reform of the whole criminal-justice system, from the police, through the courts and prisons, to the lawyers themselves. Officials at Los Pinos, the president's office, say that the package is already about 70% complete, and will be ready to present to Congress before the country's legislators begin their new session in September. The aim is to professionalise and speed up the system, as well as to make it more humane and accountable, and thus squeeze out the endemic corruption.

The country's notoriously venal and ineffective police are the first to face the chill winds of modernisation. At the moment, for historical reasons, the police are divided by function. Most belong to the Ministry for Public Security (SSP). Their job is only to “prevent” crime; they cannot investigate it or bring prosecutions. Only the police in another ministry, the procurator-general's office (PGR), can investigate crime and assemble cases against suspects. This division of responsibility at the federal level is then replicated through the country's 32 states.

Reformers argue that, at present, the country's almost 300,000 preventive police are little more than security guards, under-motivated, under-employed and under-paid. The 54,000 investigative police, on the other hand, are overwhelmed by work. Far better to combine the two functions in one police force, thus raising the number of policemen who can work on criminal cases.

All the police functions will be brought into a new Interior Ministry, which would also be responsible for prisons, immigration and other areas. The PGR would become an attorney-general's office, containing only the prosecutors. Reformers hope that to shut down one ministry, in effect, will then release funds for the Interior Ministry to professionalise the new police force. This would include better (and regular) training, and higher pay for greater responsibilities. More money would, in turn, help to end the widespread practice of topping up meagre salaries with bribes.

The other force to be professionalised will be the lawyers. At present, the approximately 300 law schools in Mexico can set their own exams, and once a student has passed the five-year course he is, in effect, beyond scrutiny for the rest of his career. Government officials argue that only about 50 of these schools are any good, and the rest “really bad”. The government therefore wants to bring in a national examination, independent of the schools. It also wants to set up a National Council of Law to oversee professional careers and to monitor ethical standards.

As well as the police and the lawyers, court proceedings and sentencing will be reformed. Currently, only 15% of cases are heard in open court, and the adversarial system barely exists. So skewed is the system in favour of the prosecution that, as one expert on Latin American law, Jan Perlin, puts it, “Once the prosecutor brings you in front of the judge, there's a strong presumption of guilt.”

The government wants to shift to more oral proceedings, to make the system less prone to corruption. The defence will be strengthened, and defence lawyers will be expected to accompany a suspect or witness at the first interrogation (a recent study suggested that they do so now in barely half of all cases). This, it is hoped, will also give more weight to the human rights of the accused. Too often, cases have been based on forced confession and torture, which is why so many avoid getting involved in the system altogether.

The government also wants to introduce greater flexibility and discretion in sentencing. At the moment, the weakest and poorest always go to prison for the pettiest of crimes, sent there by judges wedded to an authoritarian, inflexible interpretation of a convoluted penal code. One proposal, therefore, is to introduce plea-bargaining. Judges will also be given alternatives to prison, such as community service, as a punishment for minor infractions. Reformers hope that this alone will reduce the prison population by about 35%, and prevent jails becoming universities of crime for the merely wayward.

Nobody is deluding themselves that these reforms will happen overnight. They touch on too many entrenched interests for that. Legal experts point out that Chile has set itself eight years for similar reforms. And to stand any chance of success, they will have to have proper financing behind them. But if Vicente Fox's government can make a start, these reforms could be one of his most important legacies.

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Brazilian diplomacy

Trade wind

Jun 26th 2003 | RIO DE JANEIRO
From The Economist print edition

Talking up the FTAA and Mercosur

Get article background

GEORGE BUSH'S famous dictum that those countries that are not “with” the United States are “against” it seems to make an exception for Brazil. Luiz Inácio Lula da Silva, a firm though not strident opponent of the American-led war in Iraq, visited the White House last week, the first anti-war leader to do so. Despite their differences, the leaders of the superpower and of South America's biggest economy need each other. The cordiality of Brazilian-American relations would “surprise the world,” Lula declared.

One mild surprise was a strong reaffirmation of a 2005 deadline for completing the Free-Trade Area of the Americas (FTAA), which would remove most barriers among nearly all the region's economies. Few people think this likely. What each country wants most from the FTAA are concessions that the other is most reluctant to yield. For the United States, the real prizes would include new protections for intellectual property, free trade in services and a level playing-field for bidders on government contracts. Brazil wants the United States to end agricultural subsidies and to stop blocking imports through anti-dumping measures. Brazil's latest idea is to shunt all such sensitive topics off to the slow-moving global trade talks within the World Trade Organisation, putting a narrower FTAA on a faster track. But the United States has been cool to that suggestion.

Lula realises that the right sort of FTAA could help Brazil, but he prefers the superpower-free zone of Mercosur, the four-nation common-market-in-the-making that Brazil dominates. It has been an awkward grouping. Brazil and Argentina, its two most advanced members, have been plagued by economic crises; they have large industrial sectors to protect, unlike Mercosur's two smaller partners, Paraguay and Uruguay. The crises have eased, and a little-noticed summit in Asunción, which took place just before Lula met Mr Bush, began to sort out the disparities.

Brazil, which until now has pushed for uniformity on trade policy within Mercosur, showed a new flexibility as a way of speeding-up integration. The problem of unilateral defections from what is supposed to be a common external tariff will be tamed but not eliminated. Two main ones will be tolerated—for capital goods, which Argentina wants to import cheaply, and for chemicals, where Brazil wants lower tariffs—and by next year the resort to self-declared waivers is supposed to end. An agreement on government procurement, which would allow Uruguay and Paraguay five years to extend “national treatment” to contractors from their Mercosur partners, is to be completed this year. By 2006 a directly elected parliament—which would remove decisions on Mercosur rules from the national legislatures—is supposed to be in place. There is talk of bringing Bolivia (now an associate member) and Peru into the group.

Perfecting Mercosur is no substitute for an FTAA. The Inter-American Development Bank has calculated that the free-trade area would give a big boost both to Mercosur's exports and to Brazil's farm trade. But by reaffirming the 2005 deadline, Presidents Bush and Lula have also given Mercosur a push. Even if it is missed, the deadline “makes it very clear that we have to speed up” Mercosur, says a Brazilian diplomat. And a stronger Mercosur, he suggests, makes it easier to negotiate over the FTAA.

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Ecuador's customs

A tariff here, a bribe there

Jun 26th 2003 | QUITO
From The Economist print edition

AFP

Or how about diverting your goods through this tunnel?

Get article background

SOLDIERS, politicians and priests have all had their chance to reform Ecuador's rotten customs service. They have failed to do the job so far, and some have not tried very hard. Take Carlos Flores, the former president's confessor, who, as head of the Quito customs district, helped importers to evade more than $10m in tariffs. Father Flores, having acquired four houses, four flats, three cars and $140,000, is now evading justice.

The customs system has three main problems: inefficiency, tax evasion and outright corruption. Getting an imported container out of customs takes weeks or months, unless the process is greased with money or influence. Some importers use loopholes to place merchandise in lower tariff categories. Some imports are passed through a tunnel, where they bypass duties and enter the market as contraband. These and other skullduggeries, according to the Internal Revenue Service (SRI), cost the government from $600m-800m each year—let alone the millions they cost business.

President Lucio Gutiérrez, who took office in January, has made some efforts to clean house—not just because it would bring in revenue, but also because it was one of the conditions of getting a $205m deal from the IMF. Only a few days after taking office, Mr Gutiérrez ordered soldiers to take control of the customs area in the seaport of Guayaquil. He then sent a customs reform bill to Congress, in which the SRI would absorb the functions of the Ecuadorian Customs Corporation. Elsa de Mena, the SRI's director, had increased tax collection by 42% between 2000 and 2001, and the government hoped she could do the same for the customs service.

The IMF also said that customs administration should be moved from Guayaquil to Quito, the capital. But politicians on the coast complained that central government was taking their power away, so Congress vetoed the transfer. However, legislators have allowed Ms de Mena to become president of the customs-service board of directors. This, as well as efforts to synchronise data between the tax service and the customs, is a small step in the right direction.

Straightening out customs would be the ultimate test of Mr Gutiérrez's self-declared war on corruption and bureaucracy. But corrupt officials, importers and contraband-sellers will not give up without a fight. A complete reform of the system would take stronger action than the government has shown in years. A miracle, in fact.

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Peru

Running out of options

Jun 26th 2003 | LIMA
From The Economist print edition

Chaos in the government, penury outside it

Get article background

THE striking teachers may be back at work, and the streets may be calm; but last month's protests have landed Peru's president, Alejandro Toledo, in a fresh crisis. Now he must find the cash to pay the wage rises he promised. The kitty is empty, and his proposed package of emergency tax-raising measures has backfired. The wholesale resignation of his cabinet on June 23rd has forced him into a sweeping reshuffle well ahead of July 28th, when Peruvians celebrate independence and, by tradition, ministers get shifted round.

Finding competent new ones will be tough. Mr Toledo's approval ratings stand at 11%, and many wonder whether fresh faces in the cabinet can save him. Inexperienced members of his Perú Posible party are demanding key jobs, and hardliners want to keep the prime minister's post. Other allies refuse to countenance any cabinet that includes representatives from ex-President Alan Garcia's APRA party.

Completing a new cabinet, however, may prove the least of Mr Toledo's headaches. More urgent is how to keep Peru's deficit close to the 1.9% target agreed with the IMF for this year. The fragile fiscal position has been aggravated by the recent wage rises. And concessions to the teachers must inevitably be followed by similar benefits for police and health workers.

Around $220m is needed immediately. That will cover the teachers' pay-rise and a better food allowance for soldiers and police. Part of it will be raised by cutting pay for higher-paid public-sector officials, including a 30% trim for Mr Toledo himself. Ministries and government agencies will have to cut spending by 5% across the board: not enough, many critics say.

The proposed revenue-raising measures are a mixed bag. Taxes will increase on those perennial favourites, beer, cigarettes and fuel. The 18% sales and value-added tax will be extended to, among other things, long-distance bus journeys and live entertainment. Businessmen have suggested a temporary increase in VAT across the board, which would cover the cost of the emergency package. But many ministers object, saying the rate is already high and that an increase would hurt the poor.

EPA

Toledo ponders a vicuña tax

The mess underlines a basic flaw in Peru's economy. Some 70% of output falls within the grey or “informal” economy, and thus escapes tax. Tax-collections, at below 12.1% of GDP, are stagnant, with most coming from a handful of large, formal companies. Evasion is widespread, particularly among better-paid independent professionals. Not enough is coming into the coffers to pay half-decent wages

and cover the minimum capital investments the state must make.

Near-crippling, too, are levels of debt servicing and obligatory pension payments to former public-sector officials. The former currently eat up a quarter of all annual revenue, the latter another 18%. This leaves the government little room for manoeuvre, especially when no genuine effort is made to slim down the overweight apparatus of state.

Peru has resorted several times in the past 18 months to sovereign bond issues to help keep the deficit under control. But with public-sector debt already equivalent to some 47% of GDP, more such issues could lead to an Argentina-style collapse. The other revenue-raiser would be more privatisation, but Peruvians hate that. Indeed, this year to date, only $1m of a projected $400m has been raised through sell-offs and concessions. With the country caught between soaring spending and flat revenues, no wonder few sensible candidates are lining up for cabinet posts.

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China

After SARS

Jun 26th 2003 | BEIJING
From The Economist print edition

AFP

China seems to have beaten the virus. Now for the political fallout

Get article background

WHEN the World Health Organisation's director for the western Pacific, Dr Shigeru Omi, told a news conference in Beijing on June 24th that Severe Acute Respiratory Syndrome, or SARS, had been brought under control in the city and the capital was again safe for travellers, Chinese journalists broke into applause. It was indeed a moment to celebrate. The clean bill of health lifted a heavy economic burden and suggested that the government, despite its failure to stem the outbreak sooner, had at last done things right.

The Communist Party's main mouthpiece, the *People's Daily*, said the epidemic had posed a greater threat to China than both the Asian financial crisis of 1997 and the widespread flooding of the following year. But the economic impact, though severe in the travel, leisure and catering industries, appears unlikely to result in a big slowdown. Most analysts expect China to achieve at least 7% growth this year thanks to buoyant exports and foreign investment as well as governmental pump-priming. That would be only a percentage point or so below what the country would probably have achieved without SARS.

But what of the political impact? In recent weeks, a few bolder publications in China have suggested that lessons learnt from the battle against SARS should encourage the country's leaders to initiate profound changes in the way China is run. In last week's edition of an influential fortnightly magazine, *Caijing*, one of China's best known economists, Wu Jinglian, said that post-SARS China faced a choice. It could seize the opportunity to promote political and social reforms or else let “the inertia of traditional thinking” push China back on to “the old road”.

The Communist Party's Propaganda Department, which is responsible for controlling the media, clearly prefers the old ways. A Chinese magazine editor says the department has criticised several publications which dwelt on the government's mishandling of the SARS crisis. Undeterred, *Caijing* went to press last week with an edition full of provocative articles calling for political reform and press freedom, and a cover-story on a Shanghai scandal that the government is trying to suppress.

That edition has failed to make it to the news-stands. Government officials stopped it at the printers (though subscription copies went out). But many Chinese intellectuals still hope that the country's

sweeping change of leaders at a party congress last November and a legislative session in March, combined with the impact of SARS, could revive the party's long-neglected plans to match economic reforms with political change, albeit still within the framework of a one-party system.

The optimists' view is bolstered by hints in official publications that the party is at least thinking about reform. The journal *Qiushi*, an organ of the party's Central Committee, published an article last week saying the collapse of communist parties elsewhere showed that failure to carry out political reform was a “road to ruin”. An editor at a leading party journal warned in remarks published this month by an official magazine, *China Reform*, that unless China introduced more democracy at the local-government level to address growing demands for change among intellectuals, there could be a revolution.

Some expect China's new president and party leader, Hu Jintao, to broach the issue of political reform in a speech on July 1st marking the 82nd anniversary of the party's founding. He is most likely to focus on improving democracy within the party, such as giving party branches greater choice in the selection of their bosses. But blazing radical new trails—such as allowing multi-candidate elections for top party posts—would require extraordinary political daring for a leader still finding his feet. Mr Hu would have to be sure of support from Jiang Zemin, his predecessor, who is still in charge of the armed forces and leads a faction widely regarded as rivalling Mr Hu's.

Mr Jiang kept a low profile during the SARS crisis. This has allowed Mr Hu to demonstrate his leadership skills—quite effectively, many Chinese believe—once the dissembling ended. But in the last few days, as the SARS threat has retreated, there have been signs that Mr Jiang is trying to reassert his influence. The party has launched a new campaign to encourage study of Mr Jiang's theory known as the “three represents”.

A professor at the party's Central School, a training centre for top officials, says he does not expect any big breakthrough in Mr Hu's speech next week. Mr Hu, he says, will emphasise the importance of Mr Jiang's “three represents” and try to bolster his own image as a leader close to the people. There would be nothing new in that.

Last week, a group of 40 liberal Chinese scholars met in the eastern city of Qingdao to draft proposals for constitutional amendments, including a new provision inspired by SARS that would enshrine the principle of open government, and an acknowledgment of the supremacy of citizens' rights. The organiser, Cao Siyuan, says he believes the government is very likely to adopt some of the group's suggestions. “Our public servants will give thorough consideration to their masters' opinions,” says Mr Cao. China, however, has experienced too many false dawns for his confidence to be widely shared.

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China and India

Friendly giants

Jun 26th 2003 | BEIJING
From The Economist print edition

A genial summit

Reuters

Everybody needs good neighbours

JUST five years ago, India's defence minister described China as India's biggest threat. The visit to China this week of Atal Behari Vajpayee, the first by an Indian head of government in a decade, suggests a thaw is well under way.

No one was expecting Mr Vajpayee's six-day tour, due to end on June 27th, to make any dramatic breakthrough on the main point of contention, namely the delineation of the 2,200 mile (3,500km) common border. This dispute, aggravated by India's harbouring of Tibet's exiled leader, the Dalai Lama, triggered a brief war in 1962. But the two sides have now appointed senior officials to pep up negotiations. They also expressed eagerness to work on other aspects of the relationship, especially trade. Though rapidly expanding, this amounted to a mere $5 billion last year, compared with $97 billion between China and America, according to China's figures.

The two sides agreed to a new border crossing for trade between Tibet and the Himalayan territory of Sikkim, which India annexed in 1975. China has never recognised India's claim to Sikkim, but the agreement could be construed as a tacit recognition by China that Sikkim is part of India. For its part, India referred to Tibet in writing as the Tibet Autonomous Region—China's name for it—which the Chinese claimed was the first time India had explicitly recognised the “autonomous region” as part of China. Both sides insisted their positions had not really changed, though on such sensitive issues, that was no surprise.

India's cosying up to China is unlikely to have much impact on China's close relationship with Pakistan. China may have adopted a more neutral position on the Kashmir issue in recent years, but it still sees Pakistan as an important ally—partly as a buffer against India but also because a hostile Pakistan would be well placed to stir up trouble among restive Muslims in China's far west. Mr Vajpayee did complain that Pakistan was not doing enough to curb insurgents in Kashmir. But not a word has been uttered in public, at least, about China's military aid to Pakistan, including what India suspects was covert support for Pakistan's nuclear-weapons programme. India is not about to let that old grievance ruin a blossoming friendship.

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Pakistan

Payback time

Jun 26th 2003 | LAHORE
From The Economist print edition

An American thank-you

ACCORDING to President Bush, Pakistan's president, General Pervez Musharraf, is a courageous leader who has offered essential help in America's war on terror. The two leaders met at the presidential retreat in Camp David on June 24th. Mr Bush then announced the reward: $3 billion in grants over five years, a sixfold increase, of which half may be spent on weaponry. General Musharraf said he was “touched” and “grateful”. Such bonhomie was long in coming. It was President Bush senior who infuriated Pakistan when he cut off all economic and military assistance to the country in 1990 for continuing with its nuclear programme. Only after September 11th, when General Musharraf lined up stoutly behind America, was the old cold-war partnership revived.

Predictably, the reaction in Pakistan has been less enthusiastic. The religious parties have accused General Musharraf of selling out to America. Others claim he has sold Pakistan short. “We should have bargained for at least $20 billion,” said a spokesman for Benazir Bhutto's opposition party. Still others are angry that Mr Bush has endorsed the general by saying that he is on “an important mission to build...a modern Pakistan that is tolerant and prosperous”, but has sidestepped the issue of the restoration of true democracy.

What rankles most with Pakistanis, however, is America's continuing refusal to supply the F-16 fighter aircraft that were ordered and part-paid for before 1990. General Musharraf made yet another pitch for the jets last week but Mr Bush was immovable. India will be pleased: it opposes the sale of the aircraft because they can be used to deliver nuclear weapons. But some Pakistani observers are not so despondent. A slice of the money earmarked for weapons will doubtless go on upgrading Pakistan's existing fleet.

American assistance to Pakistan in the last two years is hardly peanuts. Last year the United States wrote off $1 billion in debt owed to it by Pakistan. It then nudged the IMF and other donors to weigh in with a couple of billion more of low-interest loans, and helped reschedule $12.5 billion of Pakistan's Paris Club debt. Now Mr Bush has enabled Pakistan to purchase $1.5 billion-worth of defensive weapons systems with American taxpayers' money.

The package is linked to Pakistan's progress in building peace with India and helping to crush al-Qaeda and Taliban remnants, as well as in nuclear non-proliferation and in maintaining democracy, to the extent that it exists. Its main effect, though, will be to make the general more secure on his throne.

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South-East Asia's war on terror

An uphill struggle

Jun 26th 2003 | BANGKOK
From The Economist print edition

Police are scoring successes—but this underlines the extent of the task

JUNE has been a good month for South-East Asia's counter-terrorism efforts. Police have broken up suspected terrorist cells in the Philippines, Cambodia, Thailand, and Indonesia. In Malaysia and Thailand, they have seized deadly bomb-making materials. And in Indonesia and the Philippines, the testimony of various alleged terrorists is shedding light on the connections between the region's different terrorist groups. As encouraging as all of this might sound, however, it also shows that South-East Asia's terrorists are more widely spread and firmly entrenched than the authorities had originally imagined.

Thailand, for one, had long denied that any terrorists lurked within its borders. Thaksin Shinawatra, the prime minister, once said that those who thought otherwise were “crazy people”. But he crowned a recent visit to America with the announcement that Thailand had just arrested three members of Jemaah Islamiah (JI), the group thought to have orchestrated last year's bombings in Bali. Nor had there been any proof of terrorist activity in Cambodia until four members of an alleged JI cell were arrested there. Indeed, JI has apparently even infiltrated Singapore's tiny community of Chinese Muslims, as revealed by the recent arrest of a certain John Wong, who had converted to Islam and adopted the name Arifin bin Ali.

According to the Thai police, the men they arrested were planning to plant bombs at several foreign embassies, and in resorts popular with foreigners. At any rate, the police found a map in their possession with the embassies of America, Australia, Britain, Israel and Singapore circled. If true, the story shows that JI has not gone to ground despite an international manhunt for its members. Instead, it is planning new attacks.

On the other hand, the spate of arrests also shows that South-East Asian governments are gathering better intelligence, and sharing it more smoothly. In the past, the region's best clues in the hunt for suspects have tended to come from outsiders. America, for example, tipped off Malaysia's authorities about one of their citizens' links to al-Qaeda. But possibly this is changing: Singapore provided the tip that led Thai police to their local cell, and the original information had come from a suspect arrested in Indonesia.

Governments in the region are also beginning to trace the ties between different terrorist groups. So far, it is true, Indonesian prosecutors are struggling to prove that JI even exists, let alone that Abu Bakar Basyir, a radical cleric, leads it—though that might change when detained terrorists in Malaysia and Singapore give evidence in Mr Basyir's trial, by teleconference. But the testimony of various witnesses in the trial clearly does reveal the existence of an elaborate and active international terrorist network, whatever its name and whoever its leader. In particular, one witness testified that he had trained in the Philippines at a camp of the Moro Islamic Liberation Front (MILF), a local Muslim secessionist group, before bombing a McDonald's restaurant in Indonesia. Meanwhile, in the Philippines, a MILF member testified that he had helped JI—which he, at any rate, says exists, to bomb a train station in Manila.

These incidents have embarrassed the MILF, which was already on the defensive amid a government campaign to wipe the group out. In what may well mark a significant step forward for the government of Gloria Macapagal Arroyo, MILF's leader, Salamat Hashim, recently denounced terrorism and pledged to weed out any terrorists in the ranks. But Filipino officials are not sure whether he will keep his promise,

nor, indeed, whether he has the authority to enforce it.

Meanwhile, the Thai authorities provided a terrifying example of the sort of damage terrorists might inflict if counter-terrorism efforts falter. They announced that they had nabbed a schoolteacher who was trying to sell the ingredients for a “dirty bomb”—a crude device designed to scatter radioactive material over a wide area, and much easier to make than a nuclear bomb. So far, however, they have only recovered a fraction of the material he was offering. It looks as if July will be a busy month for South-East Asia's gumshoes as well.

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Myanmar

In Insein

Jun 26th 2003 | BANGKOK
From The Economist print edition

Aung San Suu Kyi is being held in the country's nastiest prison

IT WAS bad enough when the outside world did not know where Myanmar's junta was holding Aung San Suu Kyi, the country's leading dissident and Nobel peace prize laureate. Now, the British government says it believes she has been imprisoned at Insein, Myanmar's most notorious jail. The regime, which denies the report, never kept her there during her previous stints in detention. Razali Ismail, the UN envoy who is the only person to have visited her during her month-long detention, says she is still wearing the same clothes as she was when she was arrested.

Insein is Myanmar's equivalent of Lubyanka or Robben Island. At the time of its construction, in colonial days, it was the largest prison in the British empire. Since the military took control of Burma (as Myanmar was then known) in 1962, it has served as a jail, and torture chamber, for political prisoners. Amnesty International reports that since the Red Cross began visiting Burmese jails in 1999, the situation has improved slightly. But the UN's monitor says the quality of food and health care is still inadequate.

Miss Suu Kyi is probably being treated better than the other 1,500 or so political prisoners in Myanmar. According to some reports, she is being held in a two-room hut in the prison grounds—luxurious accommodation compared to the typical tiny cell with a bucket toilet. But she is being denied visitors.

Possibly by design, the immediate fate of Miss Suu Kyi and her supporters seems to be distracting some outsiders from settling policy on Myanmar for the longer term. America and the EU have toughened sanctions a bit, and this week, Japan froze its aid. But other governments, especially Myanmar's neighbours, are saying they need a clearer picture before they can act.

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Kazakhstan

Short-lived, but still a mutiny

Jun 26th 2003 | ALMATY
From The Economist print edition

The row over land reform

Get article background

FEW issues stir the passion of lawmakers in Kazakhstan. Even fewer make them dare to mount an open challenge to the government. But privatising land, in a country that was almost totally agrarian and nomadic until Soviet times, is one such issue. Now that President Nursultan Nazarbaev plans to diversify the oil-dependent economy and develop agriculture and the depressed rural areas, however, land reform can no longer be put off. Strong opposition from parliament has sparked a crisis, culminating, on June 11th, in the prime minister's resignation.

Many members of the Mazhilis, the lower house of parliament, feared that the new land code, which will directly affect 44% of the population, will benefit only the wealthy and ruin farmers. During a heated debate in April, Serik Abdrakhmanov, a prominent deputy, questioned the need for privatisation on the grounds that most land in Kazakhstan—where nomads used to roam the steppe—has never known private ownership. Though the Mazhilis passed the law on April 30th, it appended hundreds of amendments to the government's original proposals.

One of these provided for farmers to receive plots of land free. The government had wanted to sell them at market rates. The deputies also allowed for smaller plots, and had different ideas on how the money from the sale of land to others should be used.

Incensed by these changes, Imangali Tasmagambetov, the prime minister, called for a vote of confidence. As expected, he survived it, but the vote count was a profound embarrassment: 55 out of 77 deputies voted against the government. A no-confidence motion, though, would have required a two-thirds majority in both houses. In the Senate, some of whose members are appointed by the president, 34 out of 39 supported the government.

Following the vote, MPs and opposition politicians called for a national referendum on the code. Mr Nazarbaev flatly rejected this. But something had to give, and it was probably the president who prodded Mr Tasmagambetov to resign. To put an end to the quarrel, Mr Nazarbaev thereupon returned the draft law to parliament, this time with changes of his own. The law was duly passed on June 20th. The brief mutiny by members of the Mazhilis did not block the law. But it may at least have helped many of them to achieve one thing: to keep their seats after next year's parliamentary elections.

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Japan's local economies

A central problem

Jun 26th 2003 | OSAKA AND TOKYO
From The Economist print edition

Wrangling with the national bureaucrats

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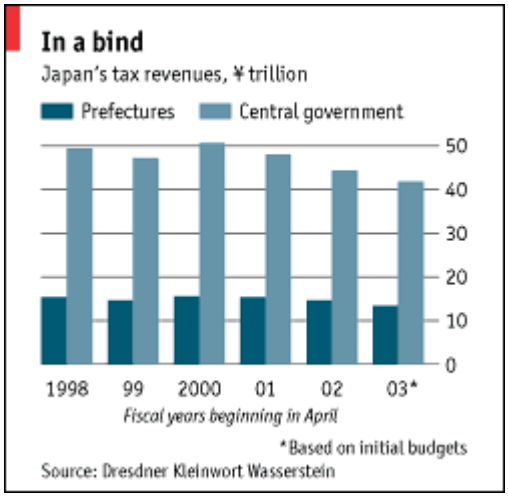

IT WAS a futile gesture, but Japan's local leaders are desperate. Earlier this month the governor of Tottori prefecture, Yoshihiro Katayama, got angry at a national panel on decentralisation when it advised the government to postpone granting more tax authority to local areas. Mr Katayama threatened to punish the panel's chairman, who is also the chairman of Toshiba, by refusing to buy equipment from the electronics giant. Though Mr Katayama soon recanted his threat, he and other governors will keep pressing the prime minister, Junichiro Koizumi, to loosen the centre's grip on local finances.

On June 26th, as *The Economist* went to press, the prime minister's Council on Economic and Fiscal Policy was preparing to approve a plan that would on its face make local governments more independent of the national treasury. But the most useful reforms have been blocked by a combination of the civil service and politicians of the ruling party. Mr Koizumi's failure once again to take on these vested interests raises doubts about whether this latest plan will genuinely give more autonomy to local governments.

The case of Osaka, Japan's second-biggest city, illustrates the problem. Demand there has been weak for more than a decade. But on top of this, Osaka has been gutted by what some locals call a “double hollowing out”. While factories have moved overseas, corporate offices, with fewer factory ties to hold them, have relocated to Tokyo. At 8.4%, the local unemployment rate is three percentage points above the national average. So bleak is the outlook that locals are vesting inordinate hope in the possibility that a summer of continuing triumphs by the local baseball team, the Hanshin Tigers, will spark a championship spending spree.

All of this has taken a toll on Osaka's prefectural government. Corporate taxes, one of Osaka's main sources of independent revenue, have fallen from ¥835 billion ($6.1 billion) in 1989 to a projected ¥334 billion this year. Spending, meanwhile, has increased. Some of the local government's financial bind is its own fault—it launched several big infrastructure projects when it thought that demand would recover—but local officials also blame the central government for dictating much of their spending. National health, welfare, and education rules determine much of the government's outlays, for example, and subsidies from the central government come with little discretionary power.

Elsewhere, many smaller prefectures are in a similar bind. Japan's total prefectural tax revenues are expected to fall to ¥13.4 trillion this year, from ¥15.3 trillion in fiscal 1998 (see chart). Kunji Okue, an economist at Dresdner Kleinwort Wasserstein in Tokyo, says that because their ability to raise taxes, borrow money and cut national programmes are all limited by Tokyo, many prefectures are forced to make large cuts in their discretionary spending.

Mr Koizumi's initial idea was to give prefectures more autonomy to spend as they choose, while giving them more discretion to set taxes. The latest plan, which calls for largely offsetting cuts in subsidies and tax transfers, merely moves money around while postponing reforms that would give local governments real freedom. Too bad they cannot boycott the central government to voice their dismay.

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Reconstructing the Middle East

But it all depends on Iraq

Jun 26th 2003 | DEAD SEA
From The Economist print edition

Reuters

America's plans for a Middle Eastern free-trade area may stand or fall by what happens in Iraq. As pipelines explode and soldiers are killed, that's not good

UNFAZED by its difficulties in Iraq, America took its roadshow to the World Economic Forum, on the shores of the Dead Sea, in a bid to launch a new Middle East. From June 21st to 23rd, American officials and businessmen, led by Colin Powell, the secretary of state, lured and cajoled Arab audiences towards a vision in which the region, in ten years' time, would be locked into a Middle East Free Trade Area (MEFTA) with the United States.

Both the Americans and the conference's host, King Abdullah of Jordan, did their utmost to stress the positive. The king organised a seaside concert, complete with fireworks and a rendering of Beethoven's ninth by local musicians. Bill Clinton and Shirley Bassey had walk-on parts at the gala dinner. And Paul Bremer, the American civil administrator in Baghdad, put the rosiest of glosses on that country's future.

But the problems for Pax Americana are mounting. This week, Baghdad's power was cut for two days, apparently after saboteurs blew holes in the oil pipelines. The damage further hindered the export of oil: after three months in the country, America has yet to export a drop of fresh oil, and its production rates are barely half the 1.5m barrels a day target set over a month ago. Even if all now goes to plan, sizeable exports will not start hitting the markets until late in the year, and it will not be until 2005 that revenues can be used for reconstruction. Mr Bremer admits that his target of $5.5 billion of oil exports by the end of the year (which would yield revenue of $3.5 billion in 2003) depends on security.

But without oil, where will the money to feed Iraq come from? Some 60-70% of Iraqis have no alternative to handouts. A conference of international donors is not planned until the autumn, and many may flinch from bankrolling a country run by America Inc, and not the United Nations. Billions of confiscated Iraqi assets might make up some of the shortfall, as might private investment.

At the Dead Sea get-together, Mr Bremer promoted trade opportunities to the assembled hundreds of businessmen, and announced the opening of a business centre in Baghdad. But with bodyguards costing $1,500 a day in Baghdad, few will commit themselves. “Definitely not,” said George Bush's brother, Neil, in Jordan to tout for Middle East outlets for his software company. “We don't want to bring our people back in body bags,” said Frank Dall, in charge of a $63m American government contract to rebuild Iraqi schools.

This leaves the American taxpayer. So far the administration has committed $2.4 billion, dressed up as its largest humanitarian programme since the second world war, and designed to serve as “a bridge between now and the time that the oil revenue comes on line.” But the sum is less than the annual $3 billion subsidy America gives Israel, and paltry compared with the post-second-world-war Marshall Plan (over $100 billion at today's value). Moreover, less than half the $2.4 billion has been allocated, and a barely a tenth actually spent. Andrew Natsios, the USAID administrator, says he has “notional ideas” what to do with the rest. But it seems unlikely to go far. “We could spend $800m on a power plant alone,” admits an official.

American officials proudly tout the refitting of Baghdad's looted ministries with local furniture to seat 100 bureaucrats each. But the Iraqis blame America for worsening a pre-war unemployment rate of 50%, by abolishing the armed forces, and its legions of security and propaganda employees. Worse, says Mr Bremer, is to come. Starved of funds to finance unwieldly state enterprises, he announced on June 22nd that subsidies would be cut. Short-term sacrifices, he said, would create “a level playing field” with the private sector. Inefficient industries would close down, or, like oil, be privatised.

The silver linings are vague. Mr Bremer promised a safety-net for redundancies, suggested that the elusive oil revenue might one day be paid out as dividends to Iraqis, and unveiled plans for a new army which two years hence would be just 10% of its former 400,000-man strength.

An American congressional delegation led by three senators flew on from the Dead Sea to Baghdad to give warning that Iraq was too important to be allowed to slip from America's grasp. “If we hadn't abandoned Afghanistan in 1991, we might have stopped it becoming an incubator for al-Qaeda,” said Richard Lugar, a Republican senator on the Foreign Relations Committee, who calls for the financing of a five-year plan for Iraq. An upset in Iraq, he suggests, could have a knock-on effect.

But American officials insist that their plans to transform Iraq into the engine for regional reform remain on track. On the sidelines of the World Economic Forum, Robert Zoellick, America's trade representative, signed up Jordan's King Abdullah and ministers from ten other Arab states to his plan for a MEFTA zone by 2013. This, he said, would be modelled on the European Union's programme for Euro-Med free trade by 2010.

The plan has more than a dash of political favouritism: rulers who embrace Israel will do best. Mr Zoellick hailed three front-running free-trade partners. These are Morocco in the west, Jordan in the centre, and Bahrain in the east, all of whom have toyed with parliaments—but ones that do nothing to upset the ruling elites. A second tier would include Tunisia, whose political reforms lag far behind its economic ones, and two former trusties, Saudi Arabia and Egypt, for whom Mr Zoellick gave warning that he had a list of American businesses that might go elsewhere. Sudan, Syria, Libya and Iran were left out altogether.

Tying economic to political reform marks a worthy shift from the period immediately after the trauma of the attacks of September 11th, when America appeared to harken to calls from regional autocrats for more repression not less. Many of Washington's mandarins now appreciate the fact that much of the violence in the region arises from popular frustration at political repression rather than miserable economic conditions.

But the reality remains far short of the promise: an army cordon kept the World Economic Forum hermetically sealed for a ten-mile radius. And unless America can make a success out of Iraq, investors fear that it will lack the credibility to press for ambitious change elsewhere.

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British casualties in Iraq

Enemies in the making

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A particularly bad week in Iraq

THE killing, by an enraged mob, of six British military policemen in south Iraq topped off a bad week for coalition forces. It was the single most deadly attack they have suffered since the war's end. Combined with a surge in other clashes and acts of sabotage, and with a continuing slowness to improve living conditions or devolve power, the incident raised fears that the ten-week-old occupation is floundering on the brink of chaos. Such fears may be premature.

The killings, in the previously peaceable town of Majar al-Kabir, 150km (95 miles) north of Basra, bore little similarity to other acts of armed resistance. Typically, these have been calculated rather than spontaneous, and concentrated in Saddam Hussein's own backyard, in the relatively affluent, Sunni-dominated region north-west of Baghdad. Majar al-Kabir, deep in Shia country, is part of the region liberated from the Baathists by Marsh Arab fighters before coalition forces arrived.

The incident, and a fierce earlier clash in the town that injured eight British soldiers, appear to have been sparked by rising local anger at what was seen as humiliating behaviour by British troops searching for weapons. Witnesses said that after the soldiers fired on armed protesters, an angered crowd shot dead two of the Britons, and then trapped, and killed, the other four inside a police station. Four Iraqis were also killed in the fighting.

But while the incident may have been a localised response to a particular grievance, it served to highlight the fact that armed occupation soldiers are not a very effective instrument for police work. By trampling on the pride of a people as prickly as the Iraqis, they risk alienating those who, like many southern Shias, were not initially hostile.

American forces appear to have generated similar reactions elsewhere. During the past week they have reported some 25 attacks a day by hostile Iraqis, nearly double the rate of recent weeks. Although officials ascribe these to Baathist renegades, many Iraqis believe the newest recruits to this budding “resistance” are simply irate patriots.

More such enemies are being created daily. A night-time air raid near the Syrian border injured five Syrian guards and killed an Iraqi woman and her baby daughter. The attack was said to have been prompted by intelligence that a convoy of senior Baathist fugitives was attempting to flee into Syria. In the event, the obliterated targets appear to have been a farming hamlet, and a ragtag caravan of Bedouin sheep smugglers.

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Israel and the Palestinians

Tunnelling their way to agreement

Jun 26th 2003 | JERUSALEM
From The Economist print edition

Against the odds, and under American pressure, two agreements are emerging

Get article background

AP

New recruits for Israel's prisons

DESPITE the blood stains en route, the Middle Eastern road map seemed at mid-week on the verge of extracting some sort of three-month ceasefire from all the Palestinian factions, including Hamas and Islamic Jihad, the two militant Islamist movements. A further agreement, between Israel and the Palestinian Authority (PA), is hoped to follow, under which the Israeli army will withdraw from the areas it re-conquered in Gaza and Bethlehem during the 33-month *intifada*.

The two agreements are crucial to Mahmoud Abbas's struggle to end the armed *intifada*. Without a ceasefire in place, the Palestinian prime minister is unable to implement the PA's security obligations under the road map: the authority has neither the capacity nor the popularity to take on the militias by force. So Mr Abbas wants to use the grace period of an Israeli withdrawal and a Palestinian ceasefire to rebuild his institutions, and persuade the Islamists to trade violence for a political stake in a future Palestinian government.

Events on the ground have worked against him. On June 21st an army undercover squad in Hebron shot dead Abdullah Qawasmeh, a Hamas military leader who Israel says was behind the deaths of 40 people. The Israeli army says Mr Qawasmeh was slain resisting arrest; Palestinian eyewitnesses say it was an assassination. In any event, it was followed by the arrest of 130 Palestinians in the city, most of them suspected Hamas members. Then, on June 25th, a day full of rumour of an imminent ceasefire, helicopter-fired rockets hit a car in southern Gaza, killing two Palestinians, one of them a woman, and wounding the presumed target.

Such actions undermine the meagre credibility that Mr Abbas commands in Palestinian public opinion. All the factions, including his own Fatah movement, make the survival of a truce conditional on an end to Israel's assassination policy, and the release of Palestinian prisoners. If Mr Abbas cannot deliver on these, the ceasefire is likely to end in the same bloody way as the four other ceasefires that Palestinian factions have announced during the current *intifada*.

But Israel's prime minister, Ariel Sharon, has laid down clearly what Israel will or won't accept. “Ticking-bomb” terrorists would still be eliminated by Israeli forces, he told a Knesset committee on June 24th, in cases where there was no time to inform the PA and demand that it act. Where there was time, he said, the Palestinians would be expected to take action, “and if they don't, we will”. This arrangement, Mr Sharon's aides maintain, is approved by the Americans, as is, they say, the prime minister's assertion that building work can continue in settlements.

Colin Powell, America's secretary of state, who held talks in Jerusalem and Ramallah on June 20th, voiced only mild criticism of Israel's killing of Mr Qawasmeh the next day. He would prefer, he said, to wake up “and find that we are moving forward and it was not necessary to have this kind of activity on either side.” The head of Israel's air force declared on June 24th that there had been no order from the government to stop helicopter-launched missile assassinations. Nor, he insisted, was there any murmuring among the pilots who carry out these missions, even though many of them result in many innocent casualties.

Some desultory dismantling of settlement outposts continues, but it seems a far cry from the

“immediate” dismantlement of outposts erected since March 2001 required in Phase I of the road map. Peace Now, an advocacy group, says there are about 60 of these, but fewer than a dozen have been removed so far, and the settlers have quickly rebuilt some of them.

Mr Sharon says the outposts must come down not because of the road map but because they are unauthorised under Israeli law. This sophistry is construed as a sop to the hard-right parties which have threatened to leave the government over the settlements. In the same vein, Mr Sharon says the building of new homes in existing settlements can continue without impediment “provided we don't make a song and dance about it”.

This hardly accords with the road map provision that requires Israel to “freeze all settlement activity (including natural growth of settlements)”. But it fully accords with what is happening on the ground. New residential areas are being built in several of the larger West Bank settlements; government grants and cheap loans are still available to home buyers; and buyers are still plentiful. Even so, settler leaders bitterly accuse the prime minister of betraying the movement that he championed and nurtured for decades.

The question now is whether the Israeli government, and the Palestinian militants, sincerely decide to give the not-very-convincing ceasefire a chance.

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Angola's weakened opposition

Conquered and divided rebels

Jun 26th 2003 | KUITO
From The Economist print edition

Angola has found peace, but UNITA has yet to find a new role

Get article background

IN THE rubble of a railway station in Kuito, a war-shattered town in Angola's central highlands, three men sit listlessly beside a pot of water. They all left home more than 20 years ago to fight with the UNITA rebels. Then, in February 2002, their leader, Jonas Savimbi, was shot and killed, and UNITA soon conceded defeat. Last month a government truck dropped the three ex-rebels back in Kuito.

Like so many of the 2m or so former soldiers and displaced civilians who are being sent home, they are finding it hard. Their dusty hometown has been blasted to rubble. Life goes on: fresh laundry hangs from hundreds of windows, conspicuously white against walls blackened by the smoke of battle. But the once-proud rebels are having to survive on food aid.

UNITA is supposed to be transforming itself from an army into a democratic opposition party, ahead of a general election that is expected within the next two years. This week in Luanda it was holding its much-postponed national congress to pick a new leader. Of the three candidates, the chances of Eduardo Chingunji were not rated high. The most popular man to win was Isaias Samakuva, who favours building a broad-based opposition with other parties. But he has to beat the stop-gap leader, Paulo Lukamba, better known as General Gato (the cat), who wants to carry on co-operating closely with the government. Several rebel chiefs have been bought off by the regime, with comfortable jobs in the army, or as ambassadors or provincial governors.

Meanwhile, their former foot-soldiers, like the three men in Kuito, are being dispersed from quartering camps to empty villages and ruined towns all over Angola. The movement's weakness is evident in Kuito and its surrounding highlands. This was Savimbi's heartland during the war, and visitors can still see his bunker nearby. But now hardly anyone admits to feeling sympathy for the old rebels.

Savimbi was respected, especially by members of his own ethnic group, but mostly he was feared. One resident recalls seeing his two brothers summarily shot in front of him, on suspicion of working for the government. Now, he says cheerfully, “Nobody fears [UNITA] any more.”

The last time UNITA fought an election, during a lull in the war in 1992, it nearly won. But this time, no one believes it is ready to mount a serious campaign. The ruling party, the MPLA, is flush with oil money. UNITA is broke, having lost its illegal diamond-hawking business when the war ended. With many of its leaders sharing titbits of power, the movement is reluctant even to criticise the government. Foreign donors have tentatively offered to help it to get organised as a proper opposition, but have been rebuffed.

Might other opposition parties take over? The government of José Eduardo dos Santos, who has ruled for 24 years, is unpopular. It is breathtakingly corrupt, and shows little sign of spending the country's oil revenues on the needs of ordinary Angolans. In theory, at least, critics of such misrule should do well.

On June 3rd a rare anti-government rally on Luanda's streets was broken up by armed police. In late May, 300 assorted opposition types—parliamentarians, traditional leaders, women's groups and so on—sat in a plush Luanda hotel for their first big meeting since the war. A Roman Catholic radio station broadcast their demands: these included a date for elections, an independent electoral commission, and Mr dos Santos to retire.

They also called for the disparate opposition groups to unite. But Rafael Marques, of the Open Society, a

pro-democracy activist group, argues that this is unlikely unless UNITA takes a lead part. Instead, small parties are proliferating. Already, 125 have registered, some no larger than a man with a suitcase, and none with any clout.

Moreover, the ideas expressed in Catholic radio broadcasts and Luanda's independent weekly newspapers are little heard outside the capital. Secret policemen, and an array of uniformed ones and soldiers, cast a shadow over any public meeting. Broken phone lines, blocked roads and disused railways all keep provincial towns isolated. “Today you don't feel confident to tell the truth,” says a man in Kuito, who refused to give his name.

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Islam in Africa

Faithful, but not fanatics

Jun 26th 2003 | BOUAKE, OMDURMAN AND ZARIA
From The Economist print edition

African Muslims are not as militant as the headlines suggest

Get article background

Music, ecstasy, trances

AT SUNSET, beneath green minarets, the dervishes of Omdurman whirled to the beat of a dozen drums, until several had spun themselves into an ecstatic trance. This spectacle of Muslim mysticism always attracts a crowd, one of whose members told your correspondent the real story behind the events of September 11th 2001. “Obviously, it was the Jews who destroyed the twin towers,” he said, “to give America a reason to attack Muslims.”

To a casual visitor, Sudan might seem gripped by the kind of Islamic extremism that westerners associate with terrorism. Sudan's Islamist government once sheltered Osama bin Laden. Under American pressure, the regime expelled him in 1996, but it is still fighting infidels from the south of the country. Sudanese Christians complain of persecution, and the public-order police enforce puritanical laws: alcohol is barred, fornicators are flogged, and God help blasphemers.

Will sub-Saharan Africa be the next breeding-ground for Islamist terror? The past week has seen a flurry of alarming headlines. On June 22nd, Greece seized a shipload of explosives bound for Sudan. (The Sudanese government angrily insisted that they were for civilian use.) On June 23rd, the government of Malawi announced that it had detained five al-Qaeda suspects. The next day, Kenyan prosecutors charged four men for their alleged role in the suicide bombing of an Israeli-owned hotel in Mombasa in November.

The most dramatic Islamist terrorist attack on African soil was in 1998, when al-Qaeda blew up the American embassies in Kenya and Tanzania, killing more than 230 people, mostly Africans. Since then, there have been some near-misses, such as a failed rocket attack on an airliner full of Israelis, and several warnings of worse to come. In February, a taped message from a man purporting to be Mr bin Laden declared that Nigeria, where street battles between Christians and Muslims have claimed hundreds of lives since 1999, was ripe for “liberation”. This week, Britain lifted a terrorist-threat-prompted ban on its airlines flying to Kenya, but Kenya recently halted flights from Somalia, a failed state which is almost entirely Muslim.

Strictly defined, terrorism is common in Africa, but very little of it is religiously motivated. Unpopular regimes, such as Zimbabwe's, often use violence to terrify restless citizens into submission. But sub-Saharan Muslims show little inclination to take up arms against the infidel West. And even civil wars that pit Muslims against non-Muslims, as in Sudan and Côte d'Ivoire, are usually more about oil, land or voting rights than about religion.

Granted, al-Qaeda has been able to recruit a few Africans to its cause, but its operations on the continent have been led by Arabs. For now, black African suicide bombers are practically unknown. This may be because African Muslims are mindful of the Prophet Muhammad's warning: “Whoever kills himself in any way will be tormented in that way in Hell.” Or it may simply be that they don't like the idea of blowing themselves up.

Attacks on western targets in Africa are relatively easy to carry out, however, not because apocalyptic terrorists enjoy much

Reuters

local support, but because security in most African countries is conveniently lax. An Ivorian policeman, for example, opening the boot of your correspondent's car to search for weapons, saw a pineapple, took it, and neglected to search the bags.

Islam was originally introduced to Africa by Arab traders, conquerors and slave-raiders, who won converts in all the countries that touch the Sahara, and along much of the eastern coastline. Many Arabs stayed on and intermarried. Educated African Muslims speak Arabic, and East Africa's lingua franca, Swahili, has Arabic roots. Many African Muslims admire and emulate Arab culture, and boast of their own Arab ancestry. Many feel more loyal to the global Muslim community, the *umma*, than to the relatively young nation-states of which they are citizens.

Both types of T-shirt sell well

But however much they may have borrowed from the Arab world, black African Muslims remain African. They believe in the same God as their Arab brothers, but they often practise their faith in subtly different ways. Countless ancient African rituals have survived, thinly disguised as Islamic ones. “We believe in God, but we still like to drink millet beer,” says Ahmed Diraige, an exiled Sudanese politician.

Sudan's is the only sub-Saharan government that has tried to impose a pure Islamic state. A radical government dominated by Sudanese of Arab descent seized power in 1989, and started breaking up wedding parties with tear gas, smashing instruments used to play secular music, and paying students to inform on insufficiently devout classmates. For a while, Sudan became one of the strictest Islamic states in the world. But the zealots' grip now appears to be relaxing.

In 1999, Hassan al-Turabi, the regime's chief Islamist ideologue, was ousted and jailed by the president, Omar Bashir. Pragmatists within the government had realised that Islamism was prolonging the civil war. Southerners, who are mostly non-Muslim and often walk around topless, were never going to submit to *sharia*.

Equally importantly, many Muslims found the government's fanaticism irksome, too. “This is a vibrant, diverse country,” says Nima El-Bagir, a young Sudanese journalist. “Hardly anyone wants to see it homogenised into a pseudo-Gulf state. We're not Arabs.”

The government is loth to admit it, but it has made concessions to popular discontent. The rules are no longer enforced so harshly. Women can still be arrested for going unveiled, but usually are not. Mixed picnics are now common in public parks, and bold couples go for moonlit walks by the Nile. Beer is smuggled into Khartoum in crates of fish, which gives the cans a distinctive smell, but does not spoil the taste.

Others go on jihad, we wear the T-shirt

Even Mr Turabi, still under house arrest, has started to talk about the need for pluralism. “Islam is a free religion. People should be free to choose,” says his wife, Weza al-Mahdi. The war still smoulders, but under American pressure both sides appear to be negotiating seriously.

How strong is militant Islam in Africa? Since September 11th 2001, “Osama” has become a popular name for northern Nigerian babies, and that familiar bearded face now adorns T-shirts and walls in Ethiopia, Tanzania and all African countries with a large Muslim population.

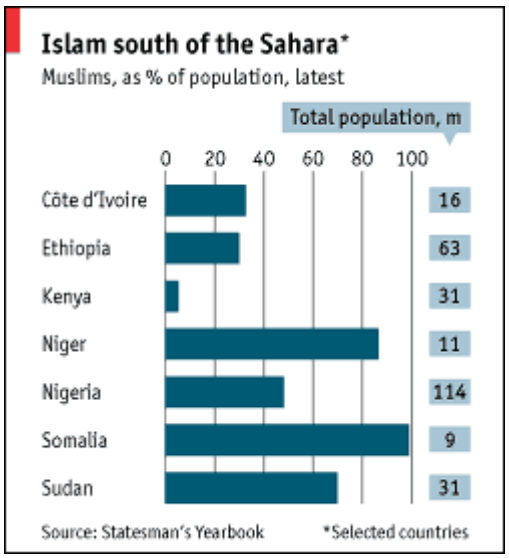
But those who pin up bin Laden posters are no more likely to be plotting murder than western students with Che Guevara posters on their walls are to be plotting violent revolution. The display is intended to provoke, and suggests little more than a rebellious grousing against the secular, western culture that dominates African television screens.

If Mr bin Laden is to be believed, Nigeria is the most prominent sub-Saharan candidate for theocracy. Since 1999, 12 out of 36 Nigerian states have announced that the *sharia* criminal code will replace the secular one. That is, adulterers will be stoned, and those who drink alcohol flogged. This is probably unconstitutional, and has led to murderous battles between Christians and Muslims in Nigeria's north, which some southerners worry could tear the country apart.

Visitors to northern Nigeria, however, find that for the most part the Muslims there are calm, moderate, and coexist peacefully with their Christian neighbours. The hotels in Kano serve excellent beer. The Coca-Cola posters feature women in mildly racy clothes. Headscarves are the norm, but on the campus of Ahmadu Bello University in Zaria your correspondent saw only one student wearing a head-to-toe *chador*. “It's a hot climate here,” explains Saidu Hassan Adamu, a political scientist at the university. Very few women wear the *chador*, he says, because it's uncomfortable. He adds: “We're not a fundamentalist society.”

So why the recent rush to impose *sharia*? It began in 1999, when the governor of Zamfara, a northern state, adopted the *sharia* criminal code. (Islamic law had long, and uncontroversially, been used for Muslim family disputes.) The governor in question was not on good terms with the central government. Espousing *sharia* immediately made him popular and untouchable, says Professor Abubakar Saddiq of the Centre for Democratic Development in Zaria. Nigeria's justice system is slow and corrupt; Muslims hoped that *sharia* courts would be swift and fair. All the other governors of mainly-Muslim states felt obliged to follow suit, so as not to appear unIslamic.

Four years on, however, Muslims are disillusioned. People have noticed, says Mr Saddiq, that some of the governors who have adopted *sharia* have no real interest in social justice. Rather, they want to harness religion to win or hold on to power, with all its perks. Not long after the first thieves had their hands cut off, people started to grumble that the big-time crooks in high places were going unpunished.



The amputations appear more or less to have stopped, and, though at least four people have been condemned to be stoned to death for adultery, none of the sentences has been carried out. Mr Adamu argues that northern Nigerians' recent experiences have made them wary of Islamic militancy. He concedes that since politicians made Islam “part of their game”, it has “hardened a small but growing minority that speaks the language of hate. But such attitudes melt in the towns, where people go about their business without thought of religion.”

He says that most people are so horrified at what the radicals have done that they will not let it happen again. “When politicians engineer a religious crisis, the people who take over are the dregs,” he says. During the riots last year in Kaduna, some of the young men manning the road blocks killed people simply because they were wearing a shirt rather than a kaftan.

Islam in Africa may not be the threat to the West that the headlines suggest, but many African Muslims are angry about what they see as America's belligerence towards their co-religionists in Iraq, and its perceived bias towards Israel. A recent survey found that the proportion of Nigerian Muslims who viewed America favourably fell from 71% to 38% in the past year. Arabic-speaking Africans get much of their news from Arab broadcasters, who tend to be fiercely anti-American.

Expressions of solidarity with the Iraqi people are common, but are Africans spoiling to join the *jihad* to expel the Americans from Baghdad? “Many people would want to fight if they had the chance,” offers Mr Adamu. That is, he says, if it were easier to get there. But has he heard of any Nigerian who has actually gone? “No.”

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Europe's farm policy

More fudge than breakthrough

Jun 26th 2003 | BRUSSELS
From The Economist print edition

Reuters

The European Union's farm reforms may be radical by the organisation's undemanding standards but will not be enough to satisfy the rest of the world

Get article background

AFTER three weeks of negotiations, including several exhausting all-night sessions, the temptation is always to declare victory and go home. So it was with the European Union's farm ministers, who struck a deal, in the early hours of June 26th, to reform the club's notoriously costly and trade-distorting farm policies.

The reform of the common agricultural policy (CAP) is a typical EU deal. It started with a proposal from the European Commission that was already cautious and complicated—and ended with a deal that was even more complex and half-hearted. The commission did not propose actually cutting the amount of money spent on farm support. The core of its proposal was instead to “decouple” subsidies and production. Decoupling is meant to ensure that farmers no longer have an incentive to produce more, regardless of the market's demand. Instead, under the commission's original proposals, they would receive flat payments which would be linked to such things as rural development and environmental protection.

The biggest recipients of CAP money—France, Spain, Ireland and Portugal—resisted this reform, since they do very well out of the present system. This week's deal preserves the principle of decoupling, but waters it down substantially.

Decoupling will begin in 2005, but countries can choose to delay its introduction until 2007. For beef there will be only partial decoupling, covering 70% of the aid, and countries will be able to choose from a complex set of options. Decoupling is also only partial in cereals and mutton. Some sectors, such as olive oil and sugar, which both absorb billions of euros in production-linked subsidies, are completely untouched, though the commission will suggest further reforms next year.

In a concession vital to winning over France, the commission agreed to ditch proposed cuts in the intervention price (a minimum price guarantee for farmers) for cereals—a move with big implications, since the cereals sector is the largest single absorber of CAP funds. There are, however, to be cuts in the intervention prices for butter and powdered milk.

Reformers and conservatives involved in European farm policy all made polite noises about the deal. “We're saying goodbye to the old subsidy system which significantly distorted international trade,” said Franz Fischler, Europe's farm commissioner. His officials argue that decoupling will finally end the era when the EU was notorious for “butter mountains” and “wine lakes”, and will let farmers respond to market signals and protect the countryside too. “The vast majority” of payments, says the commission, will now be paid independently from production. The British, always among the keenest reformers, were also pleased. “The basic deal is very good, because the principle of decoupling is now established,” said a spokesman.

Although President Jacques Chirac had personally intervened to block a deal in the earlier stages of negotiations, France ended up voting for the compromise. *Le Monde* described it as “decoupling à la carte”. Ireland's farm minister said that his country, whose farmers receive *euro*1.3 billion ($1.5 billion) a year in direct payments from the EU, was “fully satisfied”.

Such statements arouse the suspicions of countries outside the EU that had wanted a much fuller and faster reform. A diplomat from the Cairns Group of countries, which has been pushing the EU to reform the CAP, declared himself “suspicious” of the concept of partial decoupling. His initial reaction was that the deal, particularly over livestock, “reduced the impact of decoupling a lot and preserved the incentives to over-produce”.

International reactions such as these are crucial to the EU, since much of the reform effort has been driven by the Doha round of trade talks. The EU is desperate to avoid being cast as the villain, both because it has a strong economic interest in a successful trade round and because its protectionist farm policies damage its pretensions to champion development in the poor world. The Americans, whose own record on farm subsidies is hardly spotless, have put the Europeans on notice that the success or failure of the Doha round will depend on CAP reform.

European trade diplomats have every reason to put a shiny gloss on the new deal. One says that the reforms will let the EU “put a really substantial offer on the table at the next meeting in Cancun”. What seems substantial in Brussels is likely to be judged less compelling elsewhere.

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The Balkans and the European Union

The regatta sets sail

Jun 26th 2003
From The Economist print edition

Battered Balkan countries are sailing towards "Europe" at different speeds

IN QUIET moments some Balkan politicians say they miss the old days of war and strife when western leaders paid them court and almost anything they said or did was flashed around the world by journalists who hung on their every word. No longer. When the leaders of Yugoslavia's successor states plus Albania gathered near the Greek city of Salonika last week to meet their European Union counterparts at the end of a grand EU summit, Britain's Tony Blair—among other leaders—did not even stay to welcome them.

Yet that may be a good sign. Leaders of the EU's countries now have worse problems to deal with elsewhere. War between the ex-Yugoslavs, who were tearing themselves apart less than a decade ago, is no longer in the offing. The countries that emerged out of Yugoslavia's rubble are starting to co-operate again. Serbs and Croats no longer need visas to visit each others' countries. By the end of the year fast trains should run between Serbia and Slovenia; you should also, after a 12-year gap, be able to fly directly between the Serbian and Croatian capitals. Most strikingly of all, all of ex-Yugoslavia is now heading, slowly but surely, towards "Europe".

Indeed, once the EU's leaders had broadly agreed to the draft of a constitution for Europe, the only stirring declaration they had left to make was that the Western Balkans—meaning, in EU jargon, the six republics that once made up Yugoslavia, minus Slovenia but plus Albania—can all expect to join the EU, provided, of course, that they meet a mass of demanding conditions . The summit's Greek hosts were particularly keen on the Balkan declaration. They might one day become the leading country in a new EU zone.

The Balkan countries were given no dates for entry into the club. Eight central European newcomers, including ex-Yugoslav Slovenia, which plausibly claims to be no longer Balkan, plus Malta and Cyprus, are set to join next May. Bulgaria and Romania hope, rather optimistically, to be in by 2007. Turkey has no date in mind but would seek, even more optimistically, to join soon after. The EU catchphrase is the "regatta principle", meaning that countries from now on will join when qualified, rather than in groups as before.

After Slovenia, Croatia is the strongest candidate among the ex-Yugoslavs and has already passed through various stages that allow it formally to apply to join. Macedonia has reached the second of those stages, the signature of a Stabilisation and Association Agreement (SAA) with the EU, but it is too poor and still too racked by ethnic tensions between its Slav majority and ethnic-Albanian minority to qualify for early entry. Albania has started negotiating an SAA but is also much too poor and messy for fast-track expectations.

Bosnia is now the area's laggard, though it has nearly completed an EU "feasibility study" that must precede SAA talks. Until it builds genuine cross-community government structures enabling its three groups—Serbs, Croats and Muslims—to co-operate without outsiders needing to hold the ring, it has no chance of joining the club in the foreseeable future; NATO still has 12,000 peacekeeping troops there.

Serbia needs a buoy

The region's key country, whose population of 8m is twice as big as any of the other bits of former Yugoslavia, is still Serbia—and the omens there are both good and bad. In recent months it has had more than its fair share of ups and downs. In March, its energetic, reforming prime minister, Zoran Djindjic, was assassinated, probably by ultra-nationalists connected to the underworld. In the wake of his death the country has held together remarkably well. But it is not certain that its government can proceed as fast as it should, because of the links that some of its members themselves may have had, or still have, with organised crime.

Moreover, Serbia's relationship with Montenegro and Kosovo (see map) makes it even trickier for it to plot its path towards the EU. Its very loose union with Montenegro may change over the next few years. A clean break is marginally the likelier outcome. And the future status of UN-protected Kosovo (see next article) is unclear.

Still, Serbia has, in some respects, been doing better. Since the fall in October 2000 of Slobodan Milosevic, its long-time strongman, one big headache has been demands by the UN's war-crimes tribunal in The Hague for co-operation. Earlier this month the government took a bold step when special police nabbed Colonel Veselin Sljivancanin, who had been indicted for the deaths of more than 200 Croats captured when the Serbs took the Croatian town of Vukovar in 1991. His arrest means that General Ratko Mladic, the Bosnian Serbs' former army commander, is the only major alleged war criminal indicted by the court who is still at large, at least occasionally, in Serbia. Nationalists are furious, but the colonel's extradition means that American aid worth $110m should now flow in.

In any event, the effects of Mr Djindjic's assassination are by no means over. It convulsed the country. Arrests and investigations laid bare much of what many had suspected for years. Since some 45 people were charged with conspiracy to murder Mr Djindjic, it has become plain that they formed part of a whole web of interests, embracing organised-crime bosses, the secret police, a now disbanded special police unit known as the Red Berets, and people suspected of war crimes. In the words of a prominent investigative reporter, Dejan Anastasijevic, borrowing a phrase popularised during the war in Iraq, organised crime was “embedded” at the heart of Serbia's state institutions.

The country's well-being (and its progress towards the EU) much depends on how thoroughly the power of this mafia-like web has been weakened or broken since Mr Djindjic's death. In its aftermath, more than 10,000 people were arrested, of whom several hundred are still in prison. But many Serbs think that too many people close to the ruling coalition retain unsavoury links to organised crime. Some criminals are still protected by friends in the secret police with access to the files of people in government who have collaborated with them in the past. If that all came out, says Mr Anastasijevic, virtually the entire political establishment would collapse.

This week Serbia's deputy prime minister, Cedomir Jovanovic, told a hastily convened meeting of parliament's security and judicial committees that he had indeed had contacts—but in good faith—with one of the crime bosses implicated in Mr Djindjic's murder who has since died “resisting arrest”. Mr Djindjic's successor as prime minister, Zoran Zivkovic, has been mired in wrangling within his government. His ruling coalition is weak and divided. Reform has stalled. A general election is due by autumn next year but may have to be brought forward. Serbia's political climate is nasty.

Miroljub Labus, the popular leader of a reformist pressure group that has turned itself into a political party called G-17 Plus, says that a solid basis of economic reform was laid (by himself, among others) in the two years after Mr Milosevic was ousted. But most foreigners are still too nervous to invest. Mr Labus hopes that his party's demand for Serbia to break completely from Montenegro will win it votes. He also thinks, plausibly, that his party's stress on the economy should be popular. Many Serbs are desperate for jobs.

Serbia no longer menaces any of its neighbours. But it has a long way to go before it can be considered a normal, healthy country. It is some lengths behind its old rival, Croatia, in the regatta.

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Kosovo

Unresolved and left behind

Jun 26th 2003 | PRISTINA
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Kosovo is in limbo, unable even to reintegrate with the rest of the Balkans

WHILE Balkan countries are slowly tightening bonds with the European Union, Kosovo is the odd one out. Though the mainly ethnic-Albanian province is technically part of a new and loose union of Serbia and Montenegro (in fact, all that is left of old Yugoslavia), Kosovo has been a UN protectorate since 1999. But it feels anxious and lonely.

Still, its local leaders hope things are about to change. At last week's summit of EU leaders in Greece, Kosovo was represented not just by its UN proconsul, Michael Steiner, a German, but by Albanians and Serbs too. The Albanians, especially, hope talks between themselves and the Serbian government will start soon, maybe even next month. That alone would be a huge step.

Everyday issues of mutual concern would come first—transport links, energy, the validity of Kosovars'UN-issued documents and number-plates in Serbia, and the return of the 230,000-odd Serb and other refugees from Kosovo now in Serbia and Montenegro. Since 2000, only 7,000 have returned.

With an elected parliament and government, Kosovo has made big strides since war ended four years ago. But its institutions are weak, ethnic divisions almost as sharp as ever, some 57% of Kosovars have no job, and the average month's pay is $220. Bajram Rexhepi, Kosovo's prime minister, complains that the UN keeps too many powers for itself.

Kosovo's ethnic-Albanians hope that once a dialogue with Serbia begins, the place can begin to be woven back into the wider Balkans and will join the queue for the EU. It already has what is known as a “tracking mechanism” whereby it follows the stage-by-stage approach to joining the EU undertaken by other fuller-fledged Balkan countries. But many problems cannot be tackled until Kosovo's final status is clearer.

Full independence, partition or something in-between? Some Serbs have begun to contemplate independence, with guaranteed autonomy for the Serb northern bit of Kosovo and special protected status for Serb monasteries further south. In any case, Kosovo's future in Europe must depend ultimately on an agreement with Serbia. But until Serbia and Montenegro finalise their own relationship, Kosovo's own status cannot be settled. Yet the province is probably sliding towards some kind of independence.

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Honour killings in Turkey

An UnEuropean habit

Jun 26th 2003 | MARDIN
From The Economist print edition

Turkey needs to stop the practice of “honour killings”

SEMSE ALLAK, a pregnant woman, and Halil, her illicit lover (or rapist—no one quite knows), were stoned to death last November in the south-eastern province of Mardin by their relatives for shaming their families. Halil died on the spot, while Semse survived the hail of stones, only to die this month from her injuries. Her family refused to collect her corpse, for it was too “tainted”. It was left to the authorities in Diyarbakir, a nearby province where she was taken to hospital, and a valiant women's rights group called KA-MER, which has been struggling to make people more aware of these so-called honour crimes, to arrange Semse's burial.

Honour killings—or, rather, the fact that they are still tolerated by a sizeable chunk of Turkish society—are just the sort of thing that makes western Europeans think Turkey is unsuited to join the European Union. That is why, among a clutch of reforms tailored to bring the country closer to European norms and approved in parliament last week, there was a proposal to scrap an article of the penal code that allows reduced sentences for those who perpetrate crimes of honour.

But that might not be enough. The catch, says Nicole Pope, a Swiss expert in Istanbul, is that in most cases defendants are tried under the code's article 51, which allows for “extenuating circumstances” if murders are committed under “extreme provocation”. Many judges are social conservatives who interpret those words in a way that results in honour killers being punished lightly. Moreover, families who want to “cleanse their honour” often get minors to do the killing—and they get off still more lightly.

Probably scores of Turkish women are murdered every year for offences against “virtue”, including even going to the cinema with a man who is not their husband. And many such cases go unreported.

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Russia's media

Unplugged

Jun 26th 2003 | MOSCOW
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Business dealings, not censorship, are behind Russia's latest television closure

Reuters

The media must take their Lesin seriously

THE sudden disconnection of TVS, a Russian current-affairs channel, on June 22nd looked to some like another squeeze in the government's strangulation of the media. It was the last independent national network. Its star journalists were refugees from NTV, a channel so critical of President Vladimir Putin that the government took it over in 2001 and forced its owner, Vladimir Gusinsky, to flee the country. Boris Berezovsky, the boss of two other channels, and who still technically owns the licence to the frequency that TVS was (with a temporary permit) using, suffered a similar fate. And Boris Jordan, who was made director of NTV after the state took it over, and ran it as a successful and fairly independent channel, lost his job earlier this year after a row over its coverage of last October's hostage crisis when a rebel Chechen takeover of a Moscow theatre left more than 120 people dead.

Indeed, though Mr Putin enjoys sky-high ratings, he seems almost paranoid about ensuring his re-election to the presidency next March. The week before, parliament passed a law restricting the media's ability to pass comment on political candidates and parties or their platforms. And though TVS was far tamer than NTV, the Kremlin might have seen it as a potential weapon in the hands of a powerful plutocrat. It had a bevy of owners who disagreed on how to run it; but by the beginning of June one group, led by Anatoly Chubais, who also runs the state electricity company, had given up their stakes. The others, led by Oleg Deripaska, an industry magnate, could have turned the business round.

However, having already poured in tens of millions of dollars, they seemed loth to add more, and the channel was due to go off the air the very day that the press ministry pulled the plug. True, Mr Deripaska might merely have wanted to keep a low profile. But the real problem, according to Konstantin Remchukov, an MP and until recently an adviser to Mr Deripaska, was not political but financial.

Having rejected a contract with Video International, Russia's biggest advertising agency, on the grounds that the commissions were too high, it could not attract enough advertising independently, since many big advertisers work with the agency. “We were getting three or four times less revenue for each point of ratings than other channels,” says Mr Remchukov. Under Mr Jordan, NTV too stopped working with Video International.

The advertising agency was co-founded by Mikhail Lesin, now the press minister and the man who ordered the plug on TVS to be pulled. He sold his stake in it nine years ago when he began working for the state, but it has done well since, winning contracts with the main state channels, including an exclusive one with RTR, where Mr Lesin also did a spell as deputy director. Meanwhile, TVS's signal has been replaced by a state-owned channel, “Sport”. The advertising revenues from the coverage of next year's Olympics are likely to be far higher than anything TVS could pull in.

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Belgium and its laws

Universal incompetence

Jun 26th 2003 | BRUSSELS
From The Economist print edition

The Belgians may be finding their high-mindedness rather too expensive

THE moral high-ground is not always a comfortable spot. Under intense pressure from the United States, Belgium has all but scrapped its “universal competence” human-rights law, which allowed alleged violations of human rights anywhere in the world to be tried in Belgium.

Various aggrieved parties have launched cases against, among others, George W. Bush, Donald Rumsfeld, Colin Powell and Tony Blair. On a recent visit to Brussels Mr Rumsfeld said that America would refuse to release money to build a new headquarters for NATO in Brussels while its officials remained under threat of prosecution.

Within days, Guy Verhofstadt, the Belgian prime minister, proposed reforming the law so that it would apply only when the victim or the accused were resident in Belgium. He stressed that his change of heart had nothing to do with American pressure. Belgium had already amended its law once, in April, by letting its courts refer lawsuits back to the home countries of the accused, provided that those countries are deemed democratic. But this change failed to stop a string of new cases being launched. Nor has it satisfied the Americans, who said it might still get officials involved in expensive and time-consuming legal actions.

Louis Michel, the Belgian foreign minister and a prime exponent of his country's moralistic diplomacy, is also enmeshed by the law. A Flemish MP has launched a case against him for authorising the sale of machineguns to Nepal. High-minded Mr Michel says the suit against him is “mad, pernicious, irrational and malign”—and will make Belgium a laughing stock.

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France's battle for reform

Is it a turning-point?

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From The Economist print edition

Will the government's victory over pensions mean reform elsewhere?

Get article background

ECONOMIC reform follows a time-honoured ritual in France. The government proposes change. The public sector takes to the streets. The government backs down. So why is Jean-Pierre Raffarin, the French prime minister, trying hard not to appear smug after the fiercest period of strikes, in response to his proposed pension reforms, that France has witnessed in years? Has the hitherto-timid French government hardened into a steely instrument of long-overdue structural reform?

The reason for Mr Raffarin's self-satisfaction was the crumbling last week of the strikes. After over a month of chaos, with teachers, train drivers, postmen, tax-inspectors, hospital workers and more periodically bringing France's big cities to a standstill, last week's effort collapsed. Trains ran; school exams took place. Only days before, tens of thousands of people, assembled by word of mouth and by the internet, had gathered in Paris—to urge the government not to give in. “No to the blockage of our country by a few unions!” cried Edouard Fillias, one 24-year-old organiser, “No to the conservative spirit that paralyses reform!” Although parliament has yet to pass the new pension law, the government's crushing majority there makes the vote a formality and the reform now a certainty.

How has Mr Raffarin pulled this off? Three factors stand out. First, unlike Alain Juppé, a former conservative prime minister who in 1995 also tried, but failed, to reform public-sector pensions, Mr Raffarin has proved a subtle communicator. His carefully cultivated mix of provincial blokeishness and unpompous humility has gone down far better than the imperious style of Mr Juppé. Mr Raffarin has gone out of his way to consult and to appear to listen. Even with the reforms all but in the bag, Mr Raffarin resisted the temptation to look triumphant this week, and said that he would spend this summer “on the ground, talking to ordinary French people, to listen to the conclusions they draw from the national pension debate”.

Second, the government, somewhat belatedly, managed to wrap its proposed reforms in the sort of appeal to “social solidarity” that plays well in France. The French consider their pay-as-you-go pension system, whereby existing workers directly finance the pensions of their elders, a badge of the social cohesion between generations that is supposed to hold the country together. Any loss of privilege is viewed with deep suspicion. President Jacques Chirac recently put his weight behind his prime minister, urging reform so as to “preserve that which holds us together, that which cements our society”. For his part, Mr Raffarin wrote to every household, appealing to the need “not to defer the problem to your children”. It may have been tempting, politically, to hold off. But the prime minister persuaded people that, this time, there was no alternative.

A crafty operator

The third success was tactical. Early on, Mr Raffarin managed to peel one of the big trade-union groups, the CFDT, away from the others. That success was critical in dividing the union-led opposition and ensuring that basic public services ran. He then carefully chose his moment to harden his stand against the demonstrators, declaring that public employees would have pay docked for days they went on strike.

Symbolic as this victory is, does it mark the beginning of a determined reformist government in France? Possibly, but don't count on it. For a start, one reason for the success of this pension reform was that it was less ambitious than Mr Juppé's—as the former prime minister pointed out, with grudging respect, at the governing party's congress at the weekend. Its main purpose is to lengthen from 37.5 to 40 (and

later to 42) the number of years public-sector employees must work to get a maximum pension, bringing them into line with private-sector employees. This is supposed to secure the financing of pensions until 2020.

The reform does not, however, even touch certain public-sector workers, such as railwaymen and employees of the electricity and gas utilities, who are covered by special schemes. Nor, by keeping the pay-as-you-go system, does it resolve pension finance for the long term. “It's a major step in reforming the French system,” says Eric Chaney, an economist at Morgan Stanley, “but, because it assumes an optimistic level of unemployment, there's still likely to be a funding shortfall within ten years.”

Moreover, the unions are already promising a comeback in September, when the government's next round of reforms—of health insurance, along with the deferred reform of education—is due. These touch reforms for which public opinion has not been softened by years of debate, as it was over pensions. And, already, Mr Raffarin's popularity has dipped during the pension battle. His resolve will have been stiffened by his triumph. But the unions, smarting from defeat, will be steeling themselves for the next round.

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Religion in Denmark

Unholy row

Jun 26th 2003 | COPENHAGEN
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To believe or not to believe, that is the pastor's own question

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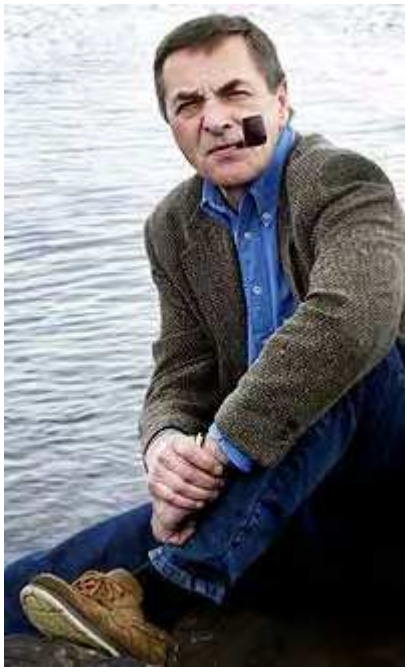

Grosboel's doctrinal sea of troubles

IT HAS been heralded as one of the biggest crises in Denmark's Evangelical Lutheran Church since King Harald Bluetooth was baptised in 960AD. “There's no heavenly God, there's no eternal life, and there's no resurrection,” said Thorkild Grosboel, pastor of the small town of Taarbaek, north of Copenhagen. In an ever more secular-minded Denmark, such views uttered by your average Dane would be about as controversial as confessing a love of raw herrings. But Pastor Grosboel thinks he should still keep his job. Others disagree.

Denmark's minister for ecclesiastical affairs, Tove Fergo, herself a Lutheran priest, says that “a priest should at the very least believe the gospel he has been employed to preach.” The local bishop has suspended the pastor from his duties. But some liberals within the church urge greater leniency.

For one thing, membership and church attendance are dropping, though at last count, a year ago, 84% of Danes still said they belonged to the state-backed Evangelical Lutheran Church. However, very few of them—between 1% and 3% of the population, one of the lowest figures in Europe—regularly attend services. Danes say that nowadays theirs is a “four-wheeler religion”: they come by pram to be baptised, roll up in smart cars for weddings, and are taken to their own funerals by hearse.

As a result, the ecclesiastical-affairs ministry (one of the few such government-run authorities in Europe) recently suggested that some churches could be sold. Denmark's Muslims, who are growing fast in number but still have neither a purpose-built mosque nor a cemetery of their own, have offered to buy some of them. Several of Denmark's anti-immigration politicians expressed outrage at the offer. The minister curtly turned it down; this week she said a new law may be brought in that would, in effect, prevent churches from being turned into mosques.

The row over the atheistic clergyman has stirred up other grievances. The Catholics, for instance, have taken the opportunity to complain about the fact that only the Lutherans get financial backing from the state. Anyone—including atheists, Muslims and members of non-Lutheran churches—can opt out of paying a tax towards the Lutheran church, but about 12% of its income comes from a direct state subsidy. Unfair, say the non-Lutherans.

Moreover, Catholics pay more to buy a burial plot, and must register births, marriages and deaths in a Lutheran church rather than at a registry office. So some have gone to the European Court of Human Rights to argue that this discriminates against non-Lutherans. The state may find it hard to keep giving perks to the Lutherans if their pastors can hold on to their jobs while denying the existence of God.

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Charlemagne

The perils of political Europe

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Ever closer political union could mean ever louder criticism of "Brussels"

THE drive to write a constitution for the European Union was meant to "bring Europe closer to the people". But in strictly practical terms Europe's leaders are less and less keen on close proximity to the general public. When the EU's leaders met in Greece on June 19th-21st—to receive the constitution's first draft, launch a new security doctrine and hobnob with an array of Balkan leaders—they gathered in Porto Carras, a remote resort some 150km (94 miles) up the coast from Salonika. Police were dotted every 500 metres along the road from the city to the summit. Nobody without security clearance was allowed within three kilometres of the conference venue. From a cavernous press room, journalists and officials could watch television pictures, broadcast live on a big screen, of a handful of demonstrators being tear-gassed outside the perimeter fence. Back in Salonika, rioters staged the now almost ritualistic arson attack on a local branch of McDonald's.

The EU is hardly unique in regularly attracting thousands of peaceful anti-globalisation demonstrators and hundreds of violent hoodlums to its summits. Similar problems surround other international meetings: think of the mayhem that attended the G8 rich countries' meeting in Genoa or the WTO's in Seattle. But the violence that now follows European summits around is a reminder of the potential perils of the EU's efforts to engage the attention of European citizens and build a "political Europe".

It is a longstanding lament of Eurocrats that the European Union, though undeniably powerful, is still too often seen as a bloodless and technocratic exercise. The most ambitious "builders of Europe" have long maintained that, after economic and monetary union, the next step must be political union. But for that to be achieved some recognisable politics needs to be injected into the European system. The EU has long excelled at high politics—cutting deals in smoke-filled rooms—but has always failed at popular politics. There is very little pan-European political debate. And Europe's media barely cover the European Parliament, though it is directly elected and increasingly important.

So the demonstrators who now follow European leaders around are, in some respects, a sign of success. Some people out there care enough about the EU to chuck stones at its leaders. What is more, the demonstrators, for all the violence that surrounds them and the inchoate nature of their complaints, are promoting a recognisable agenda. As their banners proclaim, they oppose a "Europe of capital" and support a "social Europe".

To the average anti-globaliser, the EU is now typecast as the bearer of faceless capitalist values. The Union's most attention-catching projects in the last decade have been the creation of an internal market, a single currency and an independent European central bank. British Conservatives may complain that the single-market project has turned into a nightmare of re-regulation. But for countries that have not been through Thatcherism, the EU has often been a genuinely liberalising force, compelling countries to open their markets and abandon state subsidies.

As a result, it has become a bogeyman for Europe's radical left. And while many dismiss the demonstrators as a motley collection of dope-smokers and anarchists, pollsters suggest that their demand for a "more social Europe" enjoys widespread support. In a recent Eurobarometer poll, 90% of the EU's citizens said that "fighting poverty and social exclusion" should be a top priority for the Union, against 63% who mentioned "making a success of the single currency" and 31% who stressed "welcoming new countries", ten of which will be joining the EU next year.

This poses a dilemma for EU leaders, many of whom have found the Union's liberalising agenda a useful aid in tough domestic battles to impose economic reform. Many governments used the drive to prepare for the European single currency as a cover for reducing their budget deficits in the 1990s. Cuts in

subsidies have also often been justified by a need to obey European competition laws. Italy's prime minister, Silvio Berlusconi, has proposed repeating the strategy over pension reform. Stumbling in his efforts to press on with reforms at home, he is suggesting that the EU should adopt a new Europe-wide pact to force its members to get their pensions systems into financial shape.

Brussels-bashing may be irresistible

There was always quite a risk attached to this “blame the EU” strategy. What if voters stopped accepting that EU-driven reforms are technocratic exercises for the general European good, and began to see them as highly political decisions over which they have little democratic control? What if politicians started to pander to such feeling by attacking unpopular EU decisions rather than endorsing them with a wink and a shrug? There are signs that this is beginning to happen. At the beginning of the 1990s, 72% of EU citizens regarded their countries' membership of the Union as a “good thing”; this is now down to 54%.

This tendency is only likely to be strengthened by the fact that Brussels-bashing is an increasingly popular sport, even for mainstream European politicians who would once have disdained such rhetoric as irresponsibly populist. This week, Gerhard Schröder, the German chancellor, made the latest of a series of recent attacks on “Brussels bureaucrats”, arguing that a mixture of financial liberalisation and environmental regulation was threatening to destroy large sections of German industry.

Supporters of a “political Europe” should, at least in theory, be encouraged by such developments. A pan-European democracy must necessarily involve argument and debate, even if some of it is crude and ill-informed. But there will be a price to be paid. It is already hard enough to achieve EU agreement, when it is just a question of 15 (soon to be 25) political leaders striking a deal in a conference room. Add in a stone-throwing mob outside and dipping support for the Union back home, and things will get even harder. Welcome to “political Europe”.

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Genetics

Future perfect?

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Britain is in the vanguard of genetics research, and the government wants to put this to practical use

ARGUMENTS over genetics work in opposite ways on different sides of the Atlantic. In America, genetic modification of plants raises barely an eyebrow. In Britain a rich assortment of lobby groups, now aided by Michael Meacher, the recently-sacked environment minister, has made enough noise on the issue to get supermarkets to remove GM foods from their shelves and to persuade the government to launch a summer-long public consultation before daring to lift a moratorium on commercial planting of GM crops.

In America, work on human genetics causes concern, at least where it involves embryos, for that touches on the enduring row over the sanctity of life. That's not something that bothers many people in Britain. And such pragmatism is one reason why Britain is still a world leader in human genetics research.

The birthplace of the double helix, Britain was first off the starting blocks 50 years ago. It has managed to keep pace with America's much bigger research machine ever since—especially in stem-cell research, where American scientists are hobbled by federal restrictions. A third of the Human Genome Project was carried out in the United Kingdom, and British researchers continue to break new ground in understanding the genetic links to such diseases as asthma.

Earlier this year, Britain saw the launch of the UK Biobank project, a unique initiative to analyse the genetic and biochemical profiles of 500,000 volunteers between the ages of 45-69 in order to get a better understanding of the genetic and environmental underpinnings of such afflictions as heart disease and, hopefully, develop genetic tests for early detection.

While Britain is in the vanguard of genetics research, it has been slower to apply its expertise in the clinic, says John Bell, Regius Professor of Medicine at Oxford University and head of the Biobank's scientific committee. The government is keen to change that, and this week published a white paper setting out its plans to invest an additional £50m ($84m) over the next three years to beef up genetics services and clinical research.

The government is convinced that better application of greater genetic information will help its citizens stay healthier longer, and save the National Health Service lots of money in the long run. It has, for example, asked the Human Genetics Commission, an independent advisory group, to look into the possibility of genetically screening all newborn babies to create comprehensive DNA profiles. Having a national, state-owned health service should make this easier than in countries with fragmented, private system.

This raises concerns, particularly about who would have access to genetic data. Some genetic information is already held in various databases. Worried about what would happen if people with bad genes could not get insurance, the government has negotiated a moratorium with the nation's insurers on using genetic test results to set premiums for life insurance policies—with the exception of Huntingdon's disease in the case of expensive policies. But the moratorium is set to expire in 2006, and the more information there is around, the harder it will be to balance the interests of insurers and policyholders.

Employers are also interested in having a glimpse of their employees' genetic tests, as a survey by the Institute of Directors has shown. Helen Wallace of GeneWatch, a public watchdog, worries that employers could use this information to keep workers out of pension plans, or refuse to hire certain applicants. GeneWatch is calling on the government to legislate against genetic discrimination in the workplace, just as it bans discrimination on grounds of race and sex.

The police can already access genetic information collected for medical purposes without an individual's consent, so long as a court agrees that it is in the public interest. The long arm of the law may reach further into genetics in the coming months. At present, the police can take DNA samples from people charged with an offence. If an amendment to the Criminal Justice Act, currently before the House of Lords, is passed, they could collect the DNA of anybody who is arrested, and enter this information into the national DNA database. That will probably help the police catch criminals; but it will also mean that the law holds the genetic code of more innocent people.

The government's desire to push Britain's lead in genetics is understandable. There are not many areas of science where the country can still hold its own. And this is one where the benefits are tangible, and the worries are comfortingly abstract.

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Infidelity

Is you is or is you ain't my baby?

Jun 26th 2003
From The Economist print edition

Government plans on paternity testing

IT IS a wise child that knows his own father. Genotyping means a wise father can know his own child. Testing a cheek swab from a baby can easily clear the matter up. This is a booming business in Britain, where around 10,000 such tests are thought to be carried out privately each year.

There is plenty of scope for suspicion. Robin Baker, an academic-turned-author, reviewed the available data a few years ago and estimated that as many as 10% of children may not have been sired by their supposed fathers. If the figure really is that high, a lot of hitherto stable relationships are likely to end acrimoniously, and the taxpayer will have to pick up the bill for yet more children.

That's why there was talk, in the run-up to the publication of the genetics white paper, of forbidding suspicious men from doing this without the mother's consent. In the event, the government decided against it, and opted merely to propose banning taking unauthorised DNA samples.

This prohibition (which would not extend to the police) would avoid cases such as the one in America in which investigators employed by Kirk Kerkorian, a Hollywood mogul, got hold of the DNA of Steve Bing, a socialite, to try to establish whether Mr Bing was the father of Mr Kerkorian's wife's child. And it would also discourage the plotters who tried to get hold of Prince Harry's DNA to test it and sell the results to the papers. But it would do nothing for the wife who has had a bit on the side. She needs to mind her contraceptives.

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Digital radio

Boxing clever

Jun 26th 2003
From The Economist print edition

After years of deafening silence, digital radio is taking off

FIVE years after the first sets hit the market, digital radio is suddenly taking off in Britain. In other countries, it is still a geeks-only business. Now a big investment by the radio industry, chiefly the BBC, seems to be paying off. For the first time, digital stations have appeared in the radio industry's official audience research figures. There are some serious advertisers. Newspapers and magazines have started printing programme schedules. Sales are rocketing.

Digital radio has four advantages and a problem. The first advantage is that there are lots of stations unavailable on ordinary old-fashioned radios. Oneword, for example, is a literary channel ("radio bookshop" in the words of its managing director, Ben Budworth) specialising in books read out loud. The biggest provider is the BBC, which has launched a new music channel, 1Xtra, aimed at urban youth, a traditional rock music station, a specialist Asian outlet, and a middle-brow comedy and culture offering called BBC7.

Second, quality is much better—roughly the same as playing a compact disc. Listeners to the BBC World Service find digital radio a boon, compared to the hissy short-wave reception they normally contend with. Third, there is lots of extra information—digital radios have a little screen that tells you what is on, and what is coming next. Finally, the newest digital radios offer a re-wind facility: if you missed the start of a programme or song, you can catch the beginning.

The problem so far has been that big radio manufacturers such as Sony have so far not produced a mass-market digital set. Those that are available are expensive—around £100 for the standard kitchen model, and three times that for a car radio. Only 175,000 have been sold so far. But the number now is rising fast, and a recent survey by an industry body, the Digital Radio Development Bureau, suggests that, unlike many new gadgets, digital radio reaches beyond the early-adopter market: some 20% of purchasers are female (early adopters are male) and 80% say they are less interested in the gadgets than in the services.

The industry expects numbers to double by the end of the year. In the meantime, a big chunk of listeners are using their digital televisions (which also carry radio), or the internet, rather than an actual radio set.

Unlike in digital television, where the BBC has been criticised both for spending lots of money on highbrow programming that nobody watches and for producing low-brow teen-fare that threatens to crowd out commercial providers, in digital radio the corporation's competitors are grateful for its muscle. Mr Budworth says Oneword is riding on the back of BBC7's popularity. Whether the private sector will be quite so polite when the technology is established is another question.

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Unionists

Tremble for Trimble

Jun 26th 2003 | BELFAST
From The Economist print edition

David Trimble, central figure of the peace process, may be on his way out

THE shaky Northern Ireland peace process has hit another obstacle on the road to a stable settlement. This time a vital part of it may be damaged beyond repair.

David Trimble, the leader of the largest party, the Ulster Unionists, has been under constant attack from within his party since he agreed in 1998 to share power with moderate nationalists and the IRA's political wing, Sinn Fein. This week three of his six MPs resigned the Westminster whip. It is hard to see how he can re-establish his authority and, if he is forced out, how power-sharing can resume.

The rebels—the party's president, Martin Smyth, Mr Trimble's most persistent critic, Jeffrey Donaldson, and a lesser figure, David Burnside—say that the 1998 agreement was all about concessions to the IRA and the government has been duped. Mr Donaldson led the latest move to overturn Mr Trimble's policies at a party meeting on June 16th. Mr Trimble won narrowly. A few days later, the rebels resigned the whip. Their decision means that the Ulster Unionists can no longer claim House of Commons privileges as fourth largest party.

Mr Trimble wants to discipline the rebels, but he will have difficulty. His party is so divided that it has no neutral senior figures who could man a disciplinary committee the rebels would regard as impartial. The government and other pro-agreement parties are dismayed bystanders, hoping for a swift resolution but knowing lengthy procedural wrangling is likelier.

The rebels, in alliance with Ian Paisley's Democratic Unionist Party and several smaller splinter groups, now represent the majority voice in unionism. But they are a fractious bunch. The dissident UUPMPs do not want to be assimilated by Mr Paisley's DUP, and none of them has come up with an alternative to the 1998 agreement which would be acceptable to nationalists and republicans.

The agreement was concluded between British and Irish governments, as well as NI parties. Both governments are committed to its central principle, the equal representation of British and Irish communal identities. London and Dublin would push any new Ulster Unionist leader into a similar compromise. This has been Mr Trimble's strongest card. The absence of a figure who could unite the party is another: Mr Donaldson and Mr Trimble now draw equal venom.

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Riots and refugees

After the storm

Jun 26th 2003
From The Economist print edition

A depressingly familiar story could have a happy ending

Get article background

ON JUNE 22nd a riot broke out in the normally quiet north Wales town of Wrexham between Iraqi Kurd refugees and locals. The 80-or-so refugees were sent to the 99%-white town under the government's policy of dispersing asylum-seekers out of London's overburdened boroughs to less-populated areas with empty council housing. Having been granted asylum, they got permission to stay and, since Wrexham has 2% unemployment, reckoned it was not a bad place to find a job. But they were housed on a council estate where unemployment amongst local youths was high.

Resentment, hot nights and alcohol, with the spark of a row about a mobile phone (or, according to another story, a broken window) exploded into violence. That was pretty much what happened in Sighthill, Glasgow, where the media descended to broadcast stories of fear and racism after a Turkish asylum-seeker was murdered in 2001.

The murder eventually turned out to be a mugging gone wrong, not a racial killing. But locals were angry. They had been complaining to the council for years about the state of their homes, and saw asylum-seekers being moved into recently-done-up houses. Most of the abuse against the brown-skinned people was stirred up by two or three trouble-making families egging on kids to throw stones and abuse.

The media attention had an unexpected effect. So appalled were the locals by their area's depiction as rife with crime and racism that they marched with the asylum-seekers on Glasgow Council's offices to demand action. “They were united by a joint detestation of the council and media,” says Gwynfai Jones, a local cleric.

Meetings between locals and incomers were arranged and asylum-seekers told stories of the horrors they had escaped from. Strathclyde Police pitched in by organising what has become the annual North Glasgow International Festival with football matches, dancing and food from different cultures. “The number of racist incidents has dropped dramatically,” says Alex MacDonald, the local chief inspector. “Once a few people in the community give a lead, things snowball and there is now less crime for us to tackle.”

The locals also learned that the dubious-looking brown people were doctors, architects, electricians and the like. These are badly-needed skills in Glasgow; and the children of immigrant professionals tend to work hard. Three years ago, All Saints secondary school was completely white. Now 10% of the 975 pupils are refugee children. “They are highly motivated, attend well and behave well,” says Tom McDonald, the head teacher. That, he says, has rubbed off on the locals and standards are rising.

The pity is that it seems to take a riot to kick the local authorities into action. It would be nice if refugees were recognised as an asset from the start, rather than after rioters have kicked their windows in.

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Orwell centenary

Blair-mania

Jun 26th 2003
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Britain's literati celebrate a secular saint

HE would have hated the fuss. Eric Blair (pseudonymously George Orwell) pleaded for no biography. Despite that, bookish Britain has been revelling in the celebrations for the centenary of his birth.

Everyone can claim Orwell as an ally. His anti-communism and hatred of bureaucracy chimes on the right; his anti-imperialism hits the spot for the left. Everyone thinks his debunking of wrongdoing clothed by cant applies beautifully to their political opponents.

The real story, as often the case with saints, is a bit more complicated. For all the crystalline brilliance of his writing, Orwell's political analysis was flawed. He was against war with Nazi Germany until 1940, for example. The vividness of his reporting was not always matched by scrupulousness in fact-gathering. Like two modern Blairs, Jayson and Tony, he seemed to think the end justified the means when it came to getting his message across. His biographer, Bernard Crick, suspects, for instance, that the incident supposedly portrayed in “A Hanging”, a brilliant essay based on his time in Burma, never happened, and that the events in “Shooting an Elephant” were partly fabricated.

Nonetheless, his legacy is lasting and the acclaim deserved. His political satire has lost none of its relevance. Doublethink in “1984”—“to tell deliberate lies while genuinely believing in them, to forget any fact that has become inconvenient”—sounds remarkably like what may have been going on in Downing Street in recent months. The nightmare vision of Big Brother still helps check thoughtless enthusiasm for surveillance; though—ironically, given Orwell's loathing of cliché—an asinine television show has drawn some of its power. But Orwell's greatest triumph is not what he wrote, but how he wrote it. The first injunction on the first page of *The Economist* style book is to follow the six rules set out in “Politics and the English Language”.

• Never use a metaphor, simile or other figure of speech which you are used to seeing in print.

• Never use a long word where a short one will do.

• If it is possible to cut out a word, always cut it out.

• Never use the passive where you can use the active.

• Never use a foreign phrase, a scientific word or a jargon word if you can think of an everyday English equivalent.

• Break any of these rules sooner than say anything outright barbarous.

Few saints of the church have left such useful advice.

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Railways

The pantomime horse

Jun 26th 2003
From The Economist print edition

Network Rail's deteriorating performance is under attack

Get article background

AFTER Railtrack was forced into bankruptcy in October 2001, the government transferred ownership of the country's railways to a third-wayish, not-for-profit-but-not-state-owned outfit, Network Rail. Things had been so bad under Railtrack that people assumed they could not get worse. They were wrong. There are 70% more delays than there were three years ago. Network Rail has been cancelling services to try to improve the remaining ones' punctuality, but says it will not get back to the level of reliability passengers enjoyed in 2000 (which was anyway pretty lousy by international standards) until 2010. Costs have doubled to nearly £6 billion a year while fares are rising faster than inflation.

The Strategic Rail Authority, which manages the railways for the government, is so unimpressed by Network Rail's performance that discussions have begun whether to bring the railways directly under its control—full-scale renationalisation, in other words. The proposal, favoured by some members of the SRA's board, will not find much support in the short term because the transport secretary, Alistair Darling, is opposed to further structural upheaval.

But things may come to a head next month, when Tom Winsor, the rail regulator, issues his preliminary findings on how much money is needed to run the rail network. He is likely to decide that Network Rail will need around 40% more than the £16 billion budgeted for in the five-year review period to April 2006. Mr Winsor says that if the Treasury does not increase its funding or guarantee further borrowing, the only alternatives will be to axe services or to defer essential maintenance and renewal.

Network Rail's origins were not auspicious. Stephen Byers, the transport secretary who forced Railtrack into administration, was casting around for ideas on what to do with the railways and plucked the model from a policy paper by the Institute for Public Policy and Research, one of the government's favourite think-tanks. Its structure is unusual. Its managers are answerable to a 115-member public interest board. Two-thirds are lay members chosen from more than 1,200 applicants; the remaining third are representatives of worthy bodies such as the National Farmers' Union and the Royal Association for Disability and Rehabilitation. An industry observer describes this “stakeholder” structure as “a pantomime horse with 230 legs”.

The advantage, from the government's point of view, is that it is neither one thing nor the other—neither in the private sector, which is widely regarded as having ruined the railways, nor in the public sector, which would place the outfit on the government's books and thus discomfit the Treasury by increasing public debt. The disadvantage is that it is answerable neither to shareholders nor, directly, to the Treasury. And with nobody controlling costs, they have mushroomed.

Network Rail is planning to spend £27.8 billion pounds in the five years to April 2006, £12 billion more than its budget. Mr Winsor blames these escalating costs on the company's structure. Ian McAllister, Network Rail's chairman, says this is unfair: the company inherited “a cost explosion”. It will, he says, be at least 18 months before there is visible improvement and three to five years before there is substantive change.

But Network Rail isn't helping itself. Its annual accounts, published this week, show that its five executive directors will qualify for bonuses of up to 60% of their salaries, even if the company performs worse than its much-criticised predecessor. Under Railtrack, 88% of trains arrived on time. Network Rail's maximum bonuses are based in part on punctuality improving to 84%, barely five percentage points higher than this year's bad performance. It claims the targets are “challenging” and that it is unfair to compare

performance today with standards before the Hatfield crash in 2000.

No doubt to avoid embarrassment, Network Rail initially proposed banning the media from its annual meeting on July 23rd. After an SRA spokesman pointed out that it would be “daft” for a public interest company to ban the press, Network Rail changed its mind.

Gaffes such as these have not helped relations with Network Rail's funding body. Richard Bowker, chairman of the SRA, has recently complained that it takes him eight weeks before he is able to fix up an appointment to see Ian McAllister. An SRA insider admits there is “intense frustration” with Network Rail's inability to control its costs. In response, the rail operator accuses the SRA of seeking to micro-manage. But other insiders agree with the SRA's criticisms of lax management of cost-plus maintenance contracts. “It's contractors' heaven,” said an insider. “Squillions of pounds are going down the plug hole.” To counter this criticism, Network Rail has brought three external maintenance contracts back in house and has accelerated plans to slim down its staff.

Mr McAllister claims that it is far too early to judge the performance of a company which has been in operation only since October 2002. “We didn't realise how deep the problems were before we came in,” he says. “Effectively we are having to re-engineer the company.”

Network Rail's pleas are likely to raise a wry smile from the former chairman of Railtrack, John Robinson. Railtrack was forced into bankruptcy when Mr Robinson told ministers that it could not continue without additional government funding. At that point, it was getting barely half the £3 billion a year from the taxpayer which Network Rail now says it needs.

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Taxation

Truth hurts

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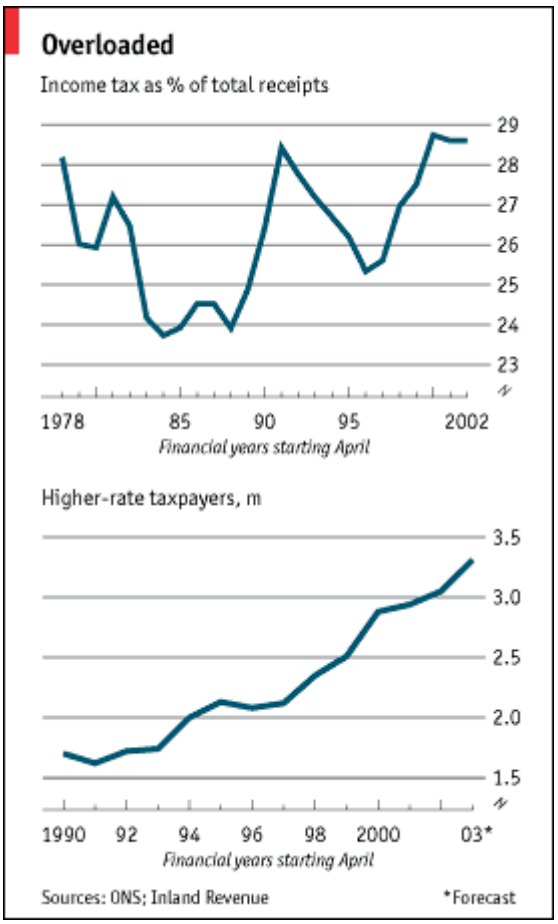
Peter Hain touched a sensitive spot

MINISTERS rarely break the government's *omerta* on tax: nobody is supposed to mention the word. So it was no surprise that Peter Hain, the new Leader of the House of Commons, was slapped down for suggesting a hike in income-tax rates for the rich to help the better-off. Tony Blair swept out of the European summit in Greece to quash the idea.



Mr Hain's sin was to deviate from a political script that has been astonishingly successful in neutralising tax as an issue for Labour: the manifesto pledge not to raise income-tax rates. That hasn't stopped income-tax receipts from rising sharply as a share of total tax revenue—reversing all the efforts of the Conservative government in the 1980s and 1990s (see chart). One reason is that special tax reliefs like the one on dividends for pension funds have been abolished. Another is the increasing number of people in work. Most important, earnings have grown fast.

This has dragged more and more people into the 40% top rate of income tax. When Labour took office in 1997, the number of taxpayers in the higher-rate band was 2.1m. Since then it has risen by 60% to 3.3m. Higher-rate taxpayers now account for over half of income-tax receipts. Their growing ranks show how the Treasury can covertly increase income tax through “fiscal drag”. Every year, the chancellor raises the higher-rate threshold in line with inflation, but this is lower than earnings growth. This year, the government has intensified fiscal drag by freezing the tax-free personal allowance.

As a result, Britain's top rate of tax is significantly lower than in many developed economies but takes effect lower down the earnings scale. This year anyone with an income above £35,115 moves into the top-rate band. By contrast, the top rate in France is almost 50% but it is levied on incomes above *euro*94,262 (£65,000) according to KPMG, an accountancy firm.

Mr Hain's solution was to soak the rich in order to help the not-so-rich. Even if this were politically feasible, his proposal shows he has learnt nothing from the experience of the past 15 years. Since Nigel Lawson lowered the top tax rate from 60% to 40% in 1988, the share of total income-tax revenues paid by the top 5% of taxpayers has shot up. Punitive rates of taxation end up punishing the tax collector.

Daft though his ideas were, Mr Hain touched a raw political nerve. The reason is that tax rises are looming. Labour is committed to big increases in spending on health over the next five years but tax revenues have faltered. There is a rare consensus among forecasters that by 2006 the government will have to put up taxes by around £10 billion, worth 1% of GDP.

Raising this amount of money will be tricky because the government has exhausted the politically easy options. In 1997, the government could launch its £5 billion stealth raid on pension funds because they were flush with surpluses. Now they're running big deficits. In the late 1990s, the fuel-tax escalator made rising taxes on motoring a nice little earner for the Treasury. But in 2000, angry protests led by lorry-drivers put paid to that money-spinner. In 2002, Gordon Brown got a warm public reception for his budget pushing up national-insurance contributions this year. But business was furious and public enthusiasm has waned since workers have started to pay the higher taxes. Now Mr Hain's remarks suggest there may be political limits to covert increases in income tax through fiscal drag.

If taxes have to rise, the option that would damage the economy least would be to levy them on spending rather than income. The International Monetary Fund advocates broadening the base of consumption taxes by ending “zero-rating” on VAT. This would raise tax revenue by 1.5% of GDP. But it would mean taxing food and children's clothes. Even with compensating income transfers to poorer people, who benefit in absolute terms less than the better-off from the tax relief, the idea is politically unpalatable.

The most sensible strategy would be to put the brakes on spending. Dosing the public services with money is a recipe for waste and inefficiency. Labour would have avoided this summer storm over tax if it had not reverted to tax-and-spend.

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The Bank of England

New team for a new Bank

Jun 26th 2003
From The Economist print edition

As Sir Eddie George retires, a new man—and woman—take over

STEADY EDDIE the media christened him, and they were right. When Mervyn King, one of his two deputies, takes over the governorship of the Bank of England from him on July 1st, Sir Edward George can look back justifiably content. After decades of sterling crises, bouts of wild inflation, panic interest rates and stop-go, the British economy, during his ten-year reign at the Bank, has at last enjoyed what it needed: calm.

He got the job soon after the speculative rush of late 1992 that hurled sterling out of the European exchange-rate mechanism. His term has seen trouble: the Barings collapse in 1995; the recent stockmarket boom and bust, with effects that are far from over; the on-going house-price bubble. But the economic basics are fairly summed up in inflation dithering for a decade around 2-3%, and his own comment on the wails of industry as interest rates peaked at 7½ % in 1998.“For much of my 37 years at the Bank,” said its governor a bit later, “I'd have given my eye-teeth for them to trough at 7½%.”

Mr King, from 1991 to 1998 chief economist there, also inherits a very different Bank. Thanks to Labour, in 1997 it won a monetary freedom unknown even in theory since old Labour nationalised it in 1946 and in practice much longer than that. But it has lost its regulatory powers. And there's another novelty. Into Mr King's shoes, in charge of interest-rate policy, steps Rachel Lomax, a high-octane civil servant now running the Department of Transport. Women this high in high finance are not ten a penny.

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Bagehot

Tony's shield

Jun 26th 2003
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Alastair Campbell faced down MPs' queries on the war, but the big questions won't go away

FOR the Westminster village, the prospect of the foreign affairs select committee grilling Alastair Campbell was mouthwatering. The committee is investigating the decision to go to war in Iraq. Mr Campbell's job title is the government's director of strategy and communications, but he is variously known as “the real deputy prime minister” and “the third most powerful man in Britain”. This has also made him one of the most hated men in the land, even among people who have only the haziest idea what he does.

Nearly all New Labour's vices, in particular its control-freakery, its obsession with spin and its pandering to tabloid prejudices, are laid at Mr Campbell's door. Mr Campbell, a former political editor of the *Daily Mirror*, may have withdrawn since the last election from the regular briefing of lobby journalists and even talked about the declining returns from spin, but he is still seen by much of the media, nearly all Labour MPs and most ministers as an almost demonic figure. He is denounced in much the same terms as Peter Mandelson—the only person, Tony Blair apart, who has done as much as Mr Campbell has to make Labour electable. Hence the excitement over what role he may or may not have played in furnishing Mr Blair with the arguments needed to win support for making war on Iraq.

If Mr Campbell could be brought low by the committee's interrogators, it would be not only a decent result for those who are still hoping to punish the government for its Iraq policy, but also a way of damaging the prime minister at one remove. Better still if Mr Blair's critics could force him into making a sacrificial offering of Mr Campbell.

There were two charges against Mr Campbell. The first was that he had “sexed up” a long and detailed report on Iraq's weapons of mass destruction (WMD) that had been compiled by the Joint Intelligence Committee (JIC) and, in a break with precedent, published last September. In particular, a bold claim that Iraq could launch an attack within 45 minutes, later repeated by Mr Blair in the Commons, had allegedly been included against the wishes of the intelligence services. The second concerned Mr Campbell's role in compiling the so-called “dodgy dossier” in which bits of a rather whiskery doctoral thesis had been passed off as the latest, hottest intelligence until, a few days after its release, the plagiarism was discovered.

Both charges are extremely serious: they go to the heart of the central concern that the government was intent on finding the evidence to support a course of action that it had already decided upon instead of using the evidence to inform its policy. Unfortunately for Mr Campbell's persecutors, it was never very likely that he would crumble before them. He is a combative and convincing performer, quite unlike the trembling civil servants who are usually dragged before select committees.

Part of the committee's problem was that from the moment the plagiarism had been revealed, the government had made no attempt to hide its mistake. Downing Street (that is to say, Mr Campbell) even let it be known a few weeks ago that it had “expressed regret” to the head of the JIC over what had happened. As Jack Straw, the foreign secretary, had admitted to the committee on June 24th, it had all been a “complete Horlicks”.

Rather than pulling the rug from under Mr Campbell, as some had suggested, Mr Straw was applying the old lawyer's trick of extravagantly conceding what had already been conceded. All that was left was for Mr Campbell, a day later, to put his hands up and say again how sorry he was that such a mistake could have been made on his watch. Entirely believably, Mr Campbell confided that the person in his office who had perpetrated the error “felt wretched”. New procedures would ensure that nothing like it would happen again.

As for the idea put about by Andrew Gilligan, a BBC defence correspondent, that Mr Campbell had corrupted the traditionally nuanced analysis usually provided by the intelligence service by his over-vigorous re-drafting of the first and much more substantial dossier, that was “a lie”. The JIC stood by the document in its entirety, said Mr Campbell, and he challenged the committee to adjudicate between him and Mr Gilligan, who had given evidence earlier.

Inside the head of Tony Blair

The committee will have to make up its mind on that one. But what is already clear is that Mr Blair no longer has much to fear from either this investigation or the less public one being carried out by the Intelligence and Security Committee. Neither can illuminate the central issue. Did Mr Blair knowingly mislead parliament and country over the threat posed by Iraq's WMD, believing he was nonetheless acting in the national interest? Or did he believe, on the basis of the intelligence reports and his discussions with President Bush, in the imminence and danger of the threat as passionately and sincerely as he claimed at the time? Clare Short, who was international development secretary until she resigned from the cabinet after the war, concludes it is the former. She thinks he is guilty of “an honourable deception”. Bagehot prefers the latter explanation.

That issue, and the moment when the decision to go to war was made, are really the only things that matter. And without access to Mr Blair's mind, all that's left is speculation.

Distressingly for Mr Blair, that speculation is likely to hang around him for a great deal longer, perhaps until he finally quits Number 10. If everything in Iraq had gone swimmingly, or even quite well, the chances are that most people would be untroubled about the reasons for Britain's being there. But the murder of six British military policemen on June 24th at the hands of Iraqi civilians was a brutal reminder of just what it is that Mr Blair, for the best of reasons, has got the country into.

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Radical birthday thoughts

Jun 26th 2003
From The Economist print edition

Our happy 160th anniversary is an unhappy time for capitalism, writes Bill Emmott, editor of The Economist

WHEN a Scottish businessman named James Wilson founded *The Economist* 160 years ago this summer, he used the conventional means of circulating a prospectus. Yet the prospectus itself was far from conventional. It did include a two-page list of the sort of articles his new publication could be expected to carry, and even a plan for the first 13 weekly editions (issue six was to be led by an article on “Free trade and the national debt”; issue ten with one on “Widow Biddle and the poor needle-women of the metropolis”). But the rest of the document consisted of a single, 14-page article, a polemical essay about the economic, social and political benefits of free trade. This 19th-century equivalent to one of today's surveys in *The Economist* began with a lament:

> It is one of the most melancholy reflections of the present day, that while wealth and capital have been rapidly increasing, while science and art have been working the most surprising miracles in aid of the human family, and while morality, intelligence, and civilisation have been rapidly extending on all hands;—that at this time, the great material interests of the higher and middle classes, and the physical condition of the labouring and industrial classes, are more and more marked by characters of uncertainty and insecurity.

Plus ça change, you might say; such words could easily have been written today, especially given that economic and technological progress seems at present to be held hostage by the uncertainties and insecurities of war, terrorism and other destabilising forces. The remedy advocated by Wilson, later reinforced by his eloquent son-in-law and successor-but-one as editor, Walter Bagehot, was liberty, particularly commercial liberty: restrictions to trade and free enterprise tended, he said, “to raise up barriers to intercourse, jealousies, animosities, and heartburnings between individuals and classes in this country, and again between this country and all others.”*The Economist* today, just as in 1843, stands four-square against heartburnings and for uninhibited intercourse.

The situation now, however, is different in a way that would bring delight to Wilson's eyes—and a feverish flow from his pen. In 1843, he was launching his newspaper at a time of entrenched protectionism, symbolised by the hated “corn laws” which restricted imports of foodstuffs and so raised the cost of living. He, and other like-minded liberals, wanted to bring a bad era to an end and to open up new possibilities. By contrast today, in 2003, the cause of liberal capitalism and poverty reduction has just had its best few decades in the whole of history.

In both periods, the consequences of a technologically driven mania cast a shadow over politics and economics: now, it is the bust following the boom of the “new economy” of information technology and the internet; in *The Economist*'s first decade it was the bust following the boom of the railways (a “headlong folly into which the country was then plunging”, in Wilson's words, in the pursuit of quick riches and in defiance of economics). But in the 1840s the main task, amid the mania, was to try to get the doors of liberty open in the first place. Now the doors have at last swung thankfully wide. The task is to keep them open.

Pressure is growing to push them closed again—or, at least, to stop them from opening any wider. That pressure has many causes. Economic crises in the poor world have reminded people of capitalism's inherent instability. Unemployment in the rich world has reminded people of its inherent tendency to create inequality and of the disruptive effect on existing jobs when poor countries such as China or India succeed in growing richer. Political tensions between America and Europe as well as between the few rich countries and the many poor, especially (though not only) in Muslim countries, lead many to doubt whether further international integration is viable. Some blame globalisation, some a lack of democratic control; others hope and pray that liberal capitalism has had its time in the sun and that now something else will be tried.

There is no clear, coherent case being presented for a retreat from liberalism. But protectionism and other forms of government intervention do not necessarily require a coherent case if they are to succeed. They prosper when ad hoc political alliances can be formed between interest groups that stand to benefit directly and people or politicians who are simply angry about something or other; and when the forces and arguments for maintaining freedom are themselves weakened, incoherent or unpopular. And they can succeed step by debilitating step, rather than in one big triumph.

If protectionism does prosper again in that way, it will be a shame for the rich world but a tragedy for the poorer countries, for it would choke off their best hope of raising their living standards and of defeating poverty. Could it happen? It is not the likeliest outcome, which, as usual, is some sort of muddling along. But it is now a worryingly plausible one. And if it comes to pass, the principal culprit, the tipper of the balance, is likely to be the abuse in recent years in the rich countries of both capitalism and democracy that coincided with, and was greatly reinforced by, the “new economy” boom of the late 1990s. For that widespread and quite outrageous abuse, by capitalists, of capitalism, threatens to weaken the forces and arguments that would otherwise defend liberty. The danger exists everywhere in the developed world, but it matters most in the United States.

The danger exists everywhere in the developed world, but it matters most in the United States

In his essay, Wilson pointed out that, during its 19th-century heyday, “The policy of England looked up to by all the world as the highway to greatness, was eagerly followed in her commercial regulations by other countries.” The same is true today of the United States, and not just in matters of commerce. This survey will, like its predecessor 160 years ago, be a polemical essay in favour of liberalism but also against the abuse of capitalism and of democracy in the country that is seen—especially by itself—as the highway to greatness. First, though, some cheerier observations, to show what is at stake.

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Liberty's great advance

Jun 26th 2003
From The Economist print edition

Liberalism has brought sharp reductions in both poverty and international inequality

THE past half-century can be seen as a long exploration of the power of liberal trade to raise living standards, not only in the rich world but among the poor too. It has also, more recently, been an exploration of people's preference, when given the choice, for democracy. The process is lamentably patchy and far from complete. Still, it has been an extraordinary success which holds great promise for the future.

The story begins with the growth that took place in western Europe, North America, Australasia and Japan once the two great scourges of economic activity—war and trade restrictions—were removed after 1945. These countries were the main signatories of the General Agreement on Tariffs and Trade in 1947 (Japan joined in 1955), which began the process of dismantling trade barriers. That group, subsequently known as "the West", increased its income per head fourfold in 1950-2001, a growth rate averaging 2.8% a year. Chart 1 shows how world GDP growth, led by the West, came to be associated with even faster growth in world trade.

The rest of the world—communist, socialist, or just plain poor—also grew, but more slowly: at 2.2% a year on average, or a threefold rise in income per head. Thus the gap between "the West and the rest", as Angus Maddison, an economic historian, described it in an OECD report in 2002 from which these figures are taken, has been widening. It is now especially wide between the richest few countries in the world and the poorest few, which are mainly in Africa; wider, indeed, than ever before. Sceptics about trade use such increases in global inequality as evidence that under liberalism the rich get richer and the poor stay poor. Yet that is wrong.

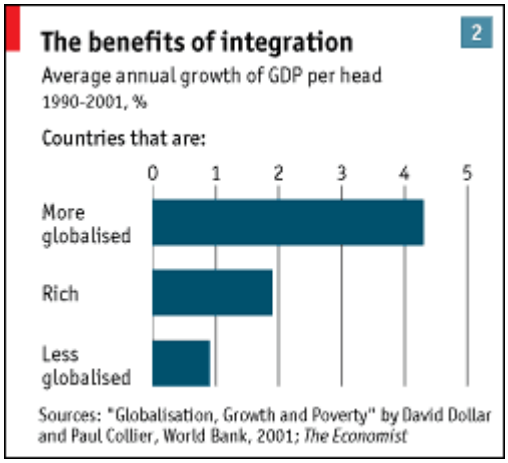
Such broad figures disguise the underlying trends. These are that countries in Asia have actually been narrowing the gap substantially: there, excluding already-developed Japan, in 1950-2001 income per head increased fivefold. In the early decades, Asian growth could be dismissed as exceptional, given that it was limited mainly to the city states of Hong Kong and Singapore, and two politically anomalous countries, Taiwan and South Korea. But since 1980, not only has growth spread to South-East Asia but it has also accelerated in the world's most populous countries, China and India. Given that Asia as a whole is home to well over half of the world's people, such progress can no longer be dismissed.

An open secret

The countries that have succeeded in raising living standards rapidly, over long periods, have followed many varieties of economic policy and have lived under many different forms of government. What they have had in common, though, has been a policy of opening their economies to trade and to foreign capital. Not fully, or even nearly so: none, except perhaps tiny Hong Kong, has followed the laisser-faire formula demonised by anti-globalists (which, incidentally, America has not followed either). Nor have they grown by somehow promoting exports and blocking all imports. Rather, they liberalised some markets in order to stimulate competition, internally and from imports; and they ensured that imports of most basic commodities and components faced few barriers, in order to keep prices down for the users of such goods. They adopted liberal trade partially, selectively and mostly gradually. But the important thing was that they adopted it.

Chart 2 shows the World Bank's depiction of the effects of such policies since 1990, a period during which the move away from

closed, centrally planned economies became a rush, following the fall of the Soviet Union in 1991. Countries that have opened their borders in this way have seen their incomes per head grow rapidly—much more rapidly than either the existing rich countries or those that have not globalised, either by choice or through lack of opportunity. There have been failures, most notably in the former Soviet Union, where Russia and its nearest neighbours, Ukraine and Belarus, suffered economic decline in the 1990s even when they did liberalise some markets; and most recently in Argentina where a fixed exchange rate combined with fiscal profligacy led to disaster. But such failures are heavily outweighed by the successes.



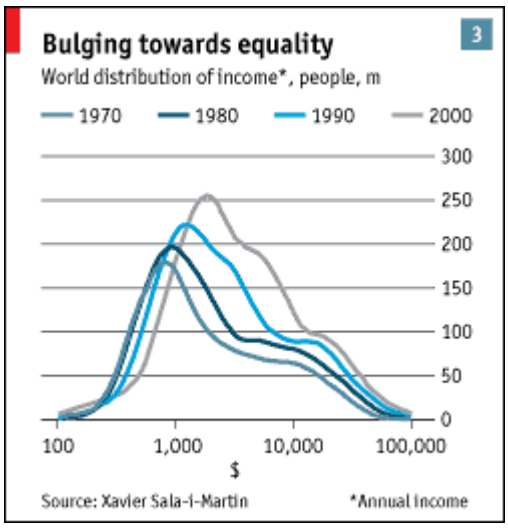
The result is that far from rising, global inequality has actually been falling substantially. Not when measured as the gap between the very richest and the very poorest. Nor when measured, as has until recently been the rather odd norm, as the difference between the average incomes of each country, regardless of population (thus counting Chad and China as if they were of equal size). But if it is measured in the way which is normal within countries, as the distribution of individual incomes, it has narrowed considerably. Given the rapid growth in China over the past 20 years, and the less rapid but still healthy growth in India, that observation makes eminent sense: huge chunks of the world's population have been climbing out of poverty. Even so, it is controversial.

Such things are, admittedly, hard to measure. There is no worldwide census of everyone's individual income, so indirect routes must be used to estimate it. But two different studies, using different methods, have now come up with broadly the same conclusion. One, by Xavier Sala-i-Martin of New York's Columbia University for America's National Bureau of Economic Research, is depicted in chart 3: it shows how rising incomes, especially in Asia, are creating what, in world terms, could be described as a huge middle class. As the bulge moves to the right of the chart, so incomes are becoming more equal.

Far from rising, global inequality has actually been falling substantially

Another study, by an Indian economist named Surjit Bhalla, in a book for the Institute for International Economics called “Imagine There's No Country”, confirmed those findings as well as the consequent drop in world poverty. Measured by the benchmark favoured by the World Bank of income of $2 a day or less, adjusted to cater for differences in purchasing power, the proportion of the world's population in poverty dropped from 56% in 1980 to 23% in 2000, on Mr Bhalla's calculations. Thanks to population growth, the absolute number of people in that category remains large: more than 1.1 billion. But that is still far fewer than in 1990 (1.7 billion) and 1980 (1.9 billion). Before 1980, the absolute numbers were rising. That date roughly coincides with the spread of trade and internal-market liberalisation to many poor countries.

The truth about market liberalisation and economic growth is not that it increases inequality, nor that it hurts the poor: just the opposite. Rather, the truth is that some large parts of the poor world are pulling themselves out of poverty while others are not. Those poorer parts include some countries in Asia, including Pakistan and Central Asia, and some in Latin America as well as most of the Middle East, where liberalisation has scarcely been attempted and revenues from oil have lately declined. Most notably, though, they include more or less a whole continent, namely Africa. There, incomes have stagnated or even declined, and life expectancies are falling too, thanks to AIDS and other plagues. Home to 13% of the world's population, the continent accounts for merely 3% of world GDP. The lack of progress in Africa, not the supposed evils of globalisation, is where the most difficult problem of economic development lies.



Democracy too

Alongside this successful growth in economic liberty, there has also been an impressive expansion of political and civil freedoms. Since 1980, according to the 2002 United Nations Human Development Report (UNHDR), 81 countries have taken “significant” steps towards democracy, with 33 military

regimes replaced by civilian governments. Of the world's nearly 200 countries, 140 now hold multi-party elections. That may not make them fully democratic, but 82 of them are, and those are home to 57% of the world's population. Especially pleasing to an independent organ such as *The Economist* is the fact that, according to the UNHDR, 125 countries, with 62% of the world's population, now have a free or partly free press. The spread of daily newspapers in developing countries has risen to 60 copies per 1,000 people, from 29 in 1970-96, and the number of televisions has increased 16-fold.

Recently, it has become fashionable to play down that progress by pointing out that many of the new democracies have not gone beyond elections to build the other, essential, protections for liberty: an independent judiciary, equality before a well-enforced rule of law, and constitutional limits on the abuse of political power. In Zimbabwe, an elected president, Robert Mugabe, has ruined the country, sponsored violence and rigged elections. Constitutions have been violated by elected politicians in Peru and Russia, and judiciaries manipulated. Venezuela's elected president, Hugo Chavez, essentially wrote his own constitution, which he hands out to visitors as a little blue book reminiscent of Mao Zedong's red one.

In sub-Saharan Africa, according to “The Future of Freedom”, a new book by Fareed Zakaria that wrings its hands about “illiberal democracy”, 42 out of 48 countries have held multi-party elections since 1990, but most have simply allowed a rotation of plundering governments. A few democracies have even collapsed: Pakistan's elected government was overturned in a coup in 1999 by General (now self-appointed President) Pervez Musharraf.

Such worries are perfectly fair. Much more progress is needed. It would be wrong to celebrate the mere holding of elections if other, arguably even more important, protections for liberty are not present or likely soon to be created. Some democracies, including long-standing ones such as Malaysia and Singapore, essentially have semi-authoritarian regimes. Yet such legitimate concerns should not be allowed to detract from the basic progress that has occurred: in the past 20 years the share of the world's population living in proper democracies has risen from about a third to just over half. Freedom House, a Washington-based think-tank, this year rated 89 countries as being “free societies”, up from 75 in 1993, and a further 55 as “partly free”. Liberty has had a period of tremendous advance on all fronts.

In the short term, there is cause for optimism that this advance will continue. Despite economic crises in East Asia, Russia and Latin America during the past six years, developing countries still seem to want to liberalise their economies. China has recently joined the World Trade Organisation, bringing the total membership to 146 countries, and Russia is in the queue for membership, along with 25 others. After shrinking slightly in 2001, the volume of world trade started to grow again in 2002, albeit weakly. Efforts have begun to try to implant democracy in Afghanistan and Iraq. Argentina has endured an economic collapse to match the Great Depression of the 1930s, yet has emerged with its democracy intact.

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Liberty's next retreat?

For all the anti-globalists' cries on their behalf, few of the world's poorer countries show signs of wanting to retreat from liberalism: their question, rather, is whether to extend it rapidly or gradually, and whether they have the domestic governmental institutions to be able to cope with it. Though it does little to promote democracy, China is proving a spur to economic liberalisation in other developing countries: fear that its growth will steal their markets or investment is prompting others to copy its reforms and to adopt international trade rules by joining the WTO. The real doubts are in the pioneers of globalisation, the rich countries.

Business is under attack, even in the homeland of free enterprise, the United States, whether from politicians, single-issue lobby groups or, most dangerously of all, from lawyers. Having made pots of cash from tobacco firms, they are turning their attention to Wall Street and to drug companies. Anti-capitalist demonstrations on May 1st in cities around the world attracted sizeable crowds. Stockmarkets remain weak, despite a quick end to the war in Iraq and a 30% fall in oil prices. So do many economies, especially the biggest and richest ones in western Europe, Japan and the United States.

Plus ça change, once again? Wherever democracy allows a crowd to gather, there will always be some who resent the selfishness inherent in the profit motive, or who stand to lose from the change that economic and technological progress or the evolution of tastes may bring, or who simply like a good march

There is always anxiety that the good times may

and love to yell abuse at the high and mighty. With the economic, social and even environmental failure of communism and its milder comrade, socialism, still fresh in the memory, there is little chance that any alternative to a capitalist economy could soon garner widespread support. And whenever economies approach the bottom of their inevitable cycles, there is always anxiety that the good times may never return. Yet they always do.

never return. Yet they always do

There are, though, some stronger reasons to worry. One, admittedly, is generic to all bad times: the fact that it is when unemployment is rising, or incomes are falling, or prospects seem dim, or threats of war and terrorism spread fear and anger, that politicians come under the greatest pressure—and temptation—to close borders or to slap controls on freedoms of all kinds, whether civil or commercial. They may wish to curry favour with domestic lobbies or merely to look as if they are doing something.

Another reason, however, is peculiar to today and risks greatly amplifying the generic one. It is that the economic and financial-market boom of the 1990s was so extreme that its bust is also producing extreme results: a pile of corporate scandals, resentment at an extraordinary widening of inequalities of income and wealth within the rich countries, a ghastly hole in the retirement funds of millions of ordinary people and, most crucially of all, a gathering disillusion about the ability of democratic institutions to hold culprits accountable for their sins.

A long way to fall

Such results can be seen, in some measure, right across the developed world. But they are at their most noticeable in the United States, for that is where the 1990s boom, along with its extremes of misbehaviour, went the furthest. In the title of a feisty and well-researched book by a commentator and political activist, Arianna Huffington, in America in recent years there were “Pigs at the Trough”, extracting gigantic executive salaries and perks, faking corporate accounts, manipulating equity offerings and granting each other vast piles of share options, among other abuses. More outrageously still, many of those benefiting from this flow of cash managed successfully to lobby Congress and the White House to reject reforms that could have stemmed some of the abuse.

When such excesses have occurred in the past, there has been a political backlash to exploit the popular anger, as under the presidencies of Teddy Roosevelt and Woodrow Wilson in the 1900s. That remains a strong possibility, even though the popularity of the famously pro-business President George Bush is running high, thanks to the wars on terror and Saddam Hussein. The danger is often expressed as one of an over-reaction to the excesses, of an excessive bout of regulation on business. That danger exists; but the worst possibility is that anger at capitalist abuses will tip the balance in domestic politics towards protectionism, as a misguided way to help the weak and vulnerable, and to pander to suspicion of markets and business. If it does, remember to blame those pigs and their love of the trough.

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Pigs, pay and power

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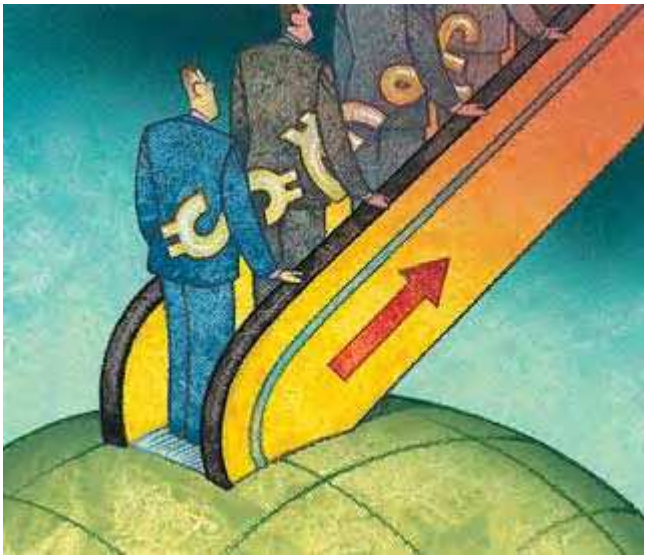

At the heart of capitalism's troubles lies executive pay

THE litany of scandals is by now familiar. Around the globe, Enron and WorldCom are household names, and who will soon forget the $15,000 umbrella stand bought for Tyco's already extravagantly paid boss, Dennis Kozlowski, with his employer's money? In America there are also Adelphia, HealthSouth, ImClone, Global Crossing, Xerox, Qwest, the hundreds of public companies that re-stated their accounts in recent years and the Wall Street investment banks accused of conflicts of interest and shady practices.

In Europe there are the false accounts of Royal Ahold, a large Dutch food distributor and retailer, the controversial payments to the German bosses of Mannesmann when they accepted Vodafone's takeover bid in 2000, the troubles of Vivendi in France and Marconi in Britain, and the bribery and other legal cases surrounding Italy's richest businessman, Silvio Berlusconi, who happens also to be its current prime minister. In Japan, ever since the stockmarket crashed in 1990 there has been a steady flow of corporate and banking scandals, over perks or cover-ups or huge debts or simple incompetence.

Is this not proof that markets cannot be allowed to rampage freely, driven as they are by greed? Well, much of this mess is cyclical, the sort of thing that happens whenever bust follows boom. As Alan Greenspan, the chairman of America's Federal Reserve, has said, in the 1990s there was no increase in human greed, just an increase in the opportunities for greedy behaviour. Japan's experience, though, following its share and property bubble in the late 1980s, is that cleaning up the mess can take a long time and a strong stomach—and that vested interests in continued corruption can delay or even prevent the clean-up.

On that analysis, the basic task is to ensure that existing laws are vigorously enforced and that any loopholes in them are closed—much more rapidly than Japan has managed. The sight of once-high-flying executives being carted off to jail ought, as in previous periods of scandal, to deter wrong-doers for a time. In America, the process is proving a little slow, but it is under way and is certainly outpacing the Japanese precedent. The table shows the progress so far in enforcing laws and tightening them up.

The problem does not, however, stop there, because a large part of it is structural, not merely cyclical. And that part has less to do with law enforcement and more to do with the way companies are owned and run. Levels of executive pay symbolise the issue, for they show what has occurred entirely legally. Those who attack pay levels are often accused of “the politics of envy”, or of failing to recognise the role of incentives. That is unfair. It is better thought of as the politics of astonishment, a tale of misdirected

incentives and misdelegated power.

Golden carrots

How big a gap should there be between the pay of an ordinary worker and that of the top executives? Once upon a time, a popular benchmark was that the boss should be paid no more than about 20-30 times the level of a lowly toiler. In America the gap has long been larger than that, though not outlandishly so. According to *Fortune* magazine, in 1970 real annual compensation averaged $1.3m (in today's money) for the top 100 chief executives, which was about 39 times the pay of an average worker. By the end of the 1990s, however, the average for *Fortune*'s top 100 was $37.5m, or 1,000 times the level for ordinary workers.

The scandal sheet 4

Company	Primary allegations[1]	Alleged culprits[2]	Investigators	Legal proceedings	Punishment
Enron	Fraudulently inflated financial results; conspiracy; money laundering	CFO, CEOs, SEs	SEC, JD, C	Grand-jury indictments; continuing investigations[3]	Assets of CFO frozen
WorldCom	Fraud; improper profiting from IPOs; inappropriate company loans; conspiracy	CFO, CEO, CT, SEs	SEC, NYSAG, JD, C	Investigations continuing; trials expected early 2004[4]	$500m company settlement with SEC on civil-fraud charges
Xerox	Fraudulently inflated financial results to profit from bonuses and stock sales	CEO, CFO, SEs	SEC, JD	JD investigation continuing	$22m settlement with SEC on civil-fraud charges[5]
Adelphia	Fraud; misuse of corporate funds by founding family	CEO, CFO, SEs	SEC, JD	Charges brought; trial expected early 2004[6]	—
Tyco	Tax evasion; misuse of company funds to inflate stock-value; inappropriate company loans	CEO, CFO, CLO	SEC, MDA	Charges brought; trial expected 2003	—
ImClone	Insider trading; tax evasion; obstructing justice	CEO, Martha Stewart	SEC, JD, C	CEO pleaded guilty to some charges	7 years' imprisonment; $3m fine
Qwest	Improperly profited from IPOs; fraudulently inflated financial results	CEO, CM, SEs	SEC, NYSAG, JD, C	Charges brought	CM has reached $4.4m settlement with NYSAG on IPO charges[5]
Global Crossing	Fraudulently inflated financial results; cashed in stock just before bankruptcy	CM	SEC, JD, C	SEC investigation continuing; JD investigation brought no charges	—
HealthSouth	Fraudulently inflated financial results; conspiracy	CEO, CFOs, SEs	SEC, JD, C	Charges brought; investigations continuing[7]	—
Ahold	False declaration of pre-tax profits	CEO, CFO, CLO, SEs[8]	Ahold internal review, SEC, JD	Probes, no charges brought as yet	—
Investment banks	Abuse of conflicts of interest	12 Wall Street firms	NYSAG, SEC, C	Investigation concluded April 2003	$1.4bn combined settlement

Keys: Culprits: CEO-Chief Executive Officer. CFO-Chief Financial Officer. CM-Chairman. CLO-Chief Legal Officer. CT-Controller. SE-Senior executive.
Investigating agencies: SEC-Securities and Exchange Commission. JD-Justice Department. C-Congress. NYSAG-New York State Attorney General. MDA-Manhattan District Attorney.

1. In general; in some cases individuals face no charges 2. At, or around, the time scandal broke. Most have now left the company concerned 3. One SE has pleaded guilty to money laundering and fraud, but not yet sentenced 4. Several SEs have pleaded guilty to conspiracy and fraud 5. Defendant/s neither admitted nor denied wrongdoing 6. SE has pleaded guilty and offered to assist inquiries 7. Five CFOs have pleaded guilty to fraud 8. Of US subsidiaries

Sources: The Corporate Library; *Washington Post*; Reuters; Securities and Exchange Commission; *Wall Street Journal*

Much of the explosion in the pay of top executives was accounted for by grants in shares and (especially) share options, which soared in value during the stockmarket bubble. Share prices have slumped since mid-2001, so has executive pay slumped too? Not exactly. Admittedly, the days when massive, jaw-dropping sums were taken by a few stars—Michael Eisner of Disney, Larry Ellison of Oracle—have gone. *Business Week*'s annual survey of the pay of America's 365 top bosses showed that the highest-paid executive in 2002, the late Alfred Lerner of MBNA bank, took a mere $194.9m, much less than the 2001 winner, Mr Ellison, who got $706.1m. Thanks to fewer such huge cash-ins, the average package for the 365 fell by a third to $7.4m. But the median pay actually rose by 5.9% to $3.7m.

In Britain, although pay levels are lower, there has been a similar process of inflation, partly under America's influence. And British executive pay has also been remarkably resilient in the face of the stockmarket's slide and of a domestic economic slowdown. A research firm, Incomes Data Services, reported in May that the basic pay of chief executives at FT-SE 100 companies rose by an average of 11.2% in 2002 and their overall earnings rose by an astonishing 23%.

The longer-term result, most noticeably in America, has been a rapid increase in incomes at the top end of the scale. Inequality as a whole has been gradually increasing for two decades, a trend generally attributed to the effects of technological change on the wages of unskilled workers. But there has also been a concentration of big gains in income and wealth for the top 1%, and within that for the top 0.1% or even 0.01%. Estimates quoted by Paul Krugman, a Princeton economist, in the *New York Times Magazine* last October showed that as of 1998, the latest figures available, the top 0.01%, a mere 13,000 taxpayers, received more than 3% of all income in America. Those 13,000, which will have included rich share-owning families, mega-entrepreneurs such as Bill Gates and many of the top executives featured in *Business Week*'s survey, then had an income of at least $3.6m and an average income of $17m. In the following few years, those figures will have ballooned even more, before sagging in 2001-02.

Does this matter? Not as such. The extremes of wealth are so remote from the

The really

lives of ordinary people that they rarely have a political impact. And America has long been much more tolerant of unequal incomes and wealth than have other countries, many of which were politically sensitised by a history of hereditary aristocracy. As long as people have felt that most of the rich earn their wealth on merit, or at least without abuse of power, and that it remains possible for ordinary people to join their ranks, inequality has mattered little. But there lies the crucial point. The really damaging perception now is that many of these mega-incomes have been gained through the abuse of power—and that, in some cases, they are also being preserved by the use of that moneyed power in politics. Worse still, the perception is largely correct.

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Egalitarians v plutocrats

Broadly, there were two contradictory trends in Anglo-American corporate culture during the 1990s. One, which grabbed the imagination during the internet boom, could be called egalitarian: it became fashionable to spread ownership widely around a company by issuing shares and share options, hierarchies were flattened, dress codes torn up and workplaces made livelier with fish-tanks, scooters and pizza. The other, though, amounted to plutocratisation: managers' interests were to be aligned with those of shareholders through options and other performance-related pay in order to ensure that companies were run to maximise “shareholder value”, but that alignment was to be concentrated on the few at the top who could really “make a difference”.

A recent book, “In the Company of Owners”, by Joseph Blasi, Douglas Kruse and Aaron Bernstein, tracked the difference between these two approaches. Egalitarianism has mainly been a feature of high-tech firms, though not only of start-ups: the authors compiled figures on 100 big high-tech firms and found that on average employees owned 33% of those companies' equity, of which 14% was held by the top managers and 19% by other employees. Microsoft, for example, has enriched Mr Gates and his top managers hugely, but it has also created thousands of millionaires among its employees.

The book compared that list with a sample of 100 large traditional firms listed on the New York Stock Exchange. There, top managers also owned 14% of the equity on average, but other employees held a mere 2%. Moreover, this was more typical across the whole economy. Although the open-necked shirts of egalitarianism hogged magazine covers during the internet boom, plutocratisation was actually the dominant trend.

This was not much noticed at first, despite the hoopla about aligning interests and creating value for shareholders, because quite a lot of the plutocrats' pay was hidden. Stock options did not have to be counted as expenses in companies' profit-and-loss accounts, and their value did not become apparent until they were exercised. Boards also lent executives huge sums of money, sometimes to buy shares in their firms but often with no specified purpose, and repayments were later waived. A lot of pay was deferred, in the form of lavish pension schemes confined to top executives. And the divorce proceedings of Jack Welch, the long-time chief executive of General Electric, showed that commitments were made to carry on providing perks to bosses well after their retirements, such as the use of corporate jets and ritzy apartments. Robert Monks, a private investor and shareholder activist, has aptly described all this as “stealth compensation”.

Why did it happen? One answer is that it is just the market at work, a market for top executives in which demand is high and supply limited. A typical riposte is that the market is rigged: pay is set by board committees comprised of other chief executives or friendly directors dependent on the chairman, advised by pay consultancies hired by the managers themselves. Both are true: pay, stealthy or overt, has been bid up between companies, making it hard for individual firms to jump off the pay escalator even if they wanted to (which few did). That is also why there has been no link between pay and performance: lacklustre firms followed the escalator too, perhaps in order to attract good managers, or out of pride, or because their shareholders failed to prevent it.

The fact that this is a market outcome does not sanctify the result

Yet the fact that this is a market outcome does not sanctify the result. It is a market driven by conflicts of interest, swelled by covert deals and protected by successful lobbying to prevent stock options from having to be accounted for as an expense, hurting reported earnings. And it has reached into the heart of government. John Snow, who is now President Bush's treasury secretary, was previously a notably well-paid boss of a notably under-performing railway company, CSX. In 1997-2001 he was paid a total of $37.4m, according to the Corporate Library, a

governance-monitoring service. He also had a Jack Welch-style post-retirement deal giving him jets, country clubs and cars. Nor was he just a lucky, passive recipient. In 1994, when he chaired the Business Roundtable, that body of big-firm chief executives lobbied the Senate to rule that options should not be treated as costs. The Senate obliged by 88 votes to nine.

These high earners drove their own pay inflation and protected it with their corporate and personal political lobbying. But how did they get the power to do so? The answer is that shareholders gave it to them, voluntarily.

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Beyond shareholder value

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Shareholder capitalism suffers from a vacuum of ownership

ANY organisation—a company, a government ministry, a charity, the local golf club—tends to become inward-looking if there is too little external discipline. Reams of academic literature have been produced to show how civil servants, however good-hearted, naturally act in their own interests, boosting their budgets, protecting their power, resisting outside scrutiny. So it is in private companies, except that managers there face discipline from competition with other firms, from the need to satisfy customers and from the demands of shareholders. Competition and pressure from customers have both become a lot more intense in most industries in the past two decades, all over the world, with beneficial effects on productivity and innovation. Pressure from shareholders, however, has not.

On the face of it, that looks an implausible claim. During the 1980s the rise of hostile takeover bids and leveraged buy-outs (LBOs) made bosses on both sides of the Atlantic keen to suck up to shareholders. Since then, chief executives have had to spend lots of their time talking to share analysts and big institutional investors to manage perceptions of their firm in the financial markets. The mantra in both America and Britain, followed by the more international firms in continental Europe too, has been that firms should be managed to create “shareholder value”—ie, rising share prices and/or dividends.

To add to the discipline, it has been assumed in Anglo-American capitalism that executives should earn bonuses tied to performance targets that bring value to shareholders; and, to align the interests even more securely, should themselves own chunks of stock and stock options. That trend took hold during the 1980s, encouraged especially by a study in 1976 by Michael Jensen, at the Harvard Business School, and William Meckling, of the University of Rochester, which explained how the interests of managers and owners had diverged, leading to slack corporate behaviour. This is not a new phenomenon. Messrs Jensen and Meckling quoted Adam Smith's 18th-century view on the same “agency problem”:

> The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot be well expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Negligence and profusion, therefore, must always prevail.

Professor Jensen's solution, then and in later studies, was to make managers act like owners by tying their incomes to profits or the firm's overall value, and to use large debts (especially through LBOs) as a further external discipline. What happened during the 1990s, however, was somewhat different, increasingly so as the decade went on.

Part of the reason was circumstantial: after a short-lived but scary crash in 1987, share prices rose almost continuously for 13 years. This meant that “shareholder value” became hard to separate from the general market rise, and that shareholders could afford to be indifferent both to mediocre relative performance and extravagant executive pay. It meant that equity capital became abundant, and the

discipline of LBOs and debt disappeared. Mergers and acquisitions roared ahead, but acquirers learned to be friendlier to the managers of firms they bought, providing big pay-offs.

The bull market also meant that shares and share options granted by boards to top executives often proved a lot more generous than initially expected: some of the new wealth came simply as a windfall as share prices soared. So extravagant pay was not entirely the boards' fault. But several other points should also be noted:

• Targets set as triggers for incentive payments came to suffer from what central bankers know as "Goodhart's law", after the academic who noted the phenomenon: any target that is set quickly loses its meaning as it comes to be manipulated.

• In any case, the setting of detailed performance targets, whether by boards or shareholders, is no easier in a private company than it used to be in the Soviet Union. The expertise required to fine-tune such targets, in the face of complex markets and organisations, is unattainable.

• However general or detailed the targets, the stockmarket's demand for smooth rises in quarterly earnings, combined with the frequent link between those earnings (or just the share-price movement) and bonus payments, provided a powerful incentive for manipulation.

Corporate-governance practices in the G7 countries 5

Key: "Yes" and "No" - statutory, or required by financial exchanges. "Recommended" - in case of deviation, company must explain why. "Voluntary" - provision is recommended, but company is not obliged to explain non-compliance.

Practice	Britain	Canada	France	Germany	Italy	Japan	United States
Auditors are independent from consultancy?	Recommended	Yes	Voluntary	No	Yes	Yes	Yes
Auditors are rotated?	Voluntary: 5–7 years	Yes: 7 years	No*	No	Yes: 9 years	Yes: 7 years	Yes**: 5 years
Shareholders vote on executive pay?	Advisory	Yes‡	No	No	Yes‡	Yes§	No
Shareholders may elect own slate of independent directors?	No	No	No	No*	Yes	Yes	No
Independent directors in a majority on board?	Recommended	No	Voluntary◊	Recommended	No	No	Yes
Expensing of stock options?	No	No	No	No	No	No	No¶
Disclose value of options?	Yes	Yes	Yes	Recommended	Yes	Yes	Yes
Separate chairman and CEO?	Recommended	Voluntary	Voluntary	Yes††	Voluntary	Voluntary	Voluntary

*Auditors have maximum term of 6 years, but it can be renewed by the board **Partners, not firm †TSE guidelines require shareholders' approval of option plans
‡When not stated in the articles of association §Shareholders determine total remuneration for the board; the remuneration of each member is then fixed by the board
*According to company's size, shareholders nominate all, 2/3 or 1/2 of the supervisory board ◊The Bouton Report advises half of board be independent in companies with dispersed ownership
¶Disclosure in annual report ††Refers to the separation of chairman of the supervisory board and the management board

Source: OECD

• The auditors supposed to be monitoring such accounting reports were appointed by the managers themselves, and dependent on them not only for continued audit fees but also for even larger consultancy business.

• Remuneration packages were set by board committees with little influence from shareholders, who left chairmen to choose supposedly independent directors too. Without any pressure to tie pay to long-term corporate performance, it was naturally linked to quite short-term measures or to none at all. The rapid rise in share prices played its part by making options exercisable increasingly quickly.

Some of the extremes of the 1990s occurred because of law-breaking and manipulation. Much, though, occurred because owners allowed it to; they delegated their powers to managers, leaving them to set pay and targets, and to monitor their own performance.

"Owners" is perhaps the most misleading word in Anglo-American capitalism

"Owners" is perhaps the most misleading word in Anglo-American capitalism, for there are not many true owners. Most are, as Rupert Pennant-Rea wrote in a survey in *The Economist* in 1990, "punters, not proprietors". The vast majority of shareholders are either small retail investors, or huge pension funds, mutual funds and insurance firms that manage diversified holdings through investment managers—and those managers face conflicts of interest, for they live off mandates from companies to manage corporate pension funds and provide insurance. The only large shareholders free of such conflicts are public-sector pension funds. They, though, share a general inhibition with other large investors: the benefits of active involvement in steering corporate boards are low whereas the costs are high. It has made much more economic sense to be passive not active, a punter not a proprietor.

The question now is whether this will change, given the slump in share prices and the scandals.

Shareholders themselves are under pressure, and the gigantic holes now appearing in corporate pension funds could give them a joint interest with managements in forcing change and boosting genuine earnings over the longer term. The deficits in funds offering “defined benefits” (ie, pensions generally linked to employees' final salaries) are estimated by America's Pension Benefit Guaranty Corporation to total some $300 billion. Those in big British companies may amount to around $100 billion. A stockmarket recovery would reduce those figures, but it would take many years of high share returns to wipe out the deficits.

That pressure may produce some change, inducing more institutions to be active rather than passive owners. In Britain in particular, there has been a spate of shareholder revolts over bosses' pay (an annual “advisory” vote on which has become a legal requirement this year), culminating in the rejection on May 19th of GlaxoSmithKline's ridiculously over-generous contract terms for its chief executive in the event of severance (he stands to receive up to £22m, or $36m).

It is also possible that LBOs and other ways to take companies out of the public stockmarkets may take the lead again, if equity capital remains scarce and the use of debt as a discipline returns to favour. Professor Jensen himself, along with other experts, has suggested better ways to tie executive pay to long-term performance: through “restricted stock” that cannot be sold for many years or, Professor Jensen's preference, special share options that require price appreciation to exceed a firm's cost of capital and are exercisable only after a long delay.

Such ideas are clever, no doubt, and might even work if implemented, making profits higher and more sustainable while bosses' pay becomes less outrageous. But they run up against two strong objections. One could be called simple complacency: although Anglo-American capitalism has become wayward in recent years, it has still fared quite well. As the Jensen and Meckling paper of 1976 concludes, “Whatever its shortcomings, the corporation has thus far survived the market test against potential alternatives.” Scandal, in other words, will deal with the worst abuses, after which things can carry on pretty much as before. The other objection is that clever ideas are not enough: corporate boards will change their ways, particularly on pay, only if they are forced to. They can already design their own special options—ones that pay out a lot, and quickly—and will continue to do so.

There is some justification for the complacent view. But a political backlash against the abuse of pay and the resulting inequality, and a long-term loss of confidence in equity markets, are high risks to take. Given the chance, it would be more prudent to reform Anglo-American capitalism. How could it be done? Mainly by government and by self-regulatory agencies such as the big stock exchanges but also, to a degree, by shareholders themselves. The best analysis of what needs doing has been provided by Mr Monks, the active American investor, and Allen Sykes, a former senior British executive. In a paper last year for the Centre for the Study of Financial Innovation, a London-based think-tank, called “Capitalism Without Owners Will Fail”, they identified the crucial issue as the vacuum of ownership, and argued that only governments can induce investing institutions to fill that vacuum by taking on some of the obligations of ownership. Once they do, the authors said, shareholders should then be able to experiment, in the market, to find the best ways of exerting such ownership.

Essentially, Messrs Monks and Sykes want governments to enforce existing trust law, which already requires fund managers and other fiduciaries to act solely in the interests of their beneficiaries. The difficult question is how. One method is already being employed, namely class-action lawsuits by beneficiaries against trustees; this may increase, given the big fund deficits. Another, suggested by Messrs Monks and Sykes, is for governments to make it a legal requirement that institutions with holdings above a large minimum, say $15m, should vote on company business. Such votes should be disclosed, so that beneficiaries can decide whether voting is being exercised in their sole interest. Further, Messrs Monks and Sykes want shareholders to have the right and obligation to nominate at least three independent directors for all big quoted companies.

These are good ideas. In addition, several important principles are much discussed but not always enforced:

• Monitors must not be allowed to be appointed by and dependent on those they monitor. So auditors should not also perform consultancy business for the firms they audit. That reform is being introduced in America. But in addition there ought to be a statutory requirement that auditing firms (not just the partners involved, as is now required) be changed, regularly.

• Independent directors should be genuinely independent. Friendships cannot be legislated against, but business ties, such as consultancy fees or supplier relationships, could be barred, either by law or by

stock-exchange requirements.

• Boards combine a strategic purpose and a monitoring role. But shareholders are neglecting their duty to their beneficiaries if they allow the first to negate the second. They will be doing so if they allow non-independent directors to control executive remuneration or auditing, for example. Boards often complain that having stronger independent directors risks harming the unity of boards and weakening the authority of the chief executive or chairman. Just so: that should be the aim.

• Companies should not be in the business of providing pensions for their employees. It exposes them to risks, as today's big deficits have shown, as well as creating conflicts of interest with fund managers and shareholders. Yet tax breaks continue to induce them to run such schemes, or to goad employees to keep their pension plans heavily invested in the firm's shares—as was shown at Enron. Those incentives ought to be abolished.

Active ownership

If these proposals and principles were to be followed, shareholders ought then to be able to find their own ways of becoming active owners or at least of exercising their obligations. Claude Bébéar, for example, the head of Axa, a giant French insurance firm, has suggested in a recent book, “Ils Vont Tuer le Capitalisme” (They are going to kill capitalism), that not only should voting by shareholders be compulsory but also that companies should be allowed to give longer-term shareholders more voting power and/or higher dividends. Currently, this is forbidden by the convention (sometimes rule) that all shareholders in publicly listed companies should be treated equally.

As long as such arrangements are fully disclosed (as Mr Bébéar recommends), and freely voted upon in the first place, this seems a perfectly good idea to try. Provided that shareholders know what they are letting themselves in for when they buy shares, they should surely be allowed to have such differential voting powers—which are common enough in various forms of private company (such as The Economist Group). Other methods that may make active ownership more viable could include the use of new intermediaries paid to monitor, vote and even find directors, which after all is part of what private equity funds do already.

But is any of this likely to happen? Complacency, and a belief that capitalism can cope simply by muddling through, may prevent it. So, too, however, may governments' squeamishness about enforcing or even recommending things that businessmen don't like. In the more liberal era of the past 20 years governments have often been accused of being too devoted to markets. Actually, a more telling accusation is that they have been too devoted to business.

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Pro-market, not pro-business

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Governments should keep their distance from businesses and their bosses

THE critiques vary. Some British commentators allege that companies have taken over the role of government, creating a “Captive State” (in the title of a book by George Monbiot, a *Guardian* journalist) or have made a “Silent Takeover” of sovereignty (a book by Noreena Hertz, a Cambridge academic). Others simply think the free-market era was a “False Dawn” and is over (John Gray, of the London School of Economics). Americans have tended to focus on the role of lobbyists and political corruption (“Pigs at the Trough”, by Arianna Huffington, cited earlier; “Government's End”, by Jonathan Rauch, a columnist for the *National Journal* and formerly a writer for *The Economist*), or on the relationship between “Wealth and Democracy” (Kevin Phillips, a distinguished political writer). Or on the domination of the Bush administration by “big” or just “Texas” oil interests (too many critics to mention, of all nationalities).

Is there any truth to all this? One thing these critiques are not compatible with is the common notion that the nation state is dead, its powers handed over to markets by “fundamentalists” (ie, the deregulation and privatisation led by Ronald Reagan in America and Margaret Thatcher in Britain in the 1980s), or usurped by globalisation or supranational institutions (the European Union, the WTO, etc). For if the state had few powers left, it would not be worth capturing, bribing or otherwise suborning. But it has, and it is. Corruption, by firms and individuals seeking to exploit governments' vast powers, is indeed a big problem for democracies all over the world. Yet it is not the whole problem. Governments remain far too keen to do businessmen's bidding even when no money is offered.

Why, for example, have share options not been treated as a cost in corporate accounts, or taxed equally with other personal income? A partial answer is that doing so is not easy—the right price is difficult to determine, the cost is mainly one of dilution of existing shareholders' equity stakes rather than a direct cost to the firm, and the income is hard to evaluate until the options are exercised. If the will had been there, however, those hurdles could have been overcome. So the most tempting explanation for why nothing has been done, given America's political ways, is corporate lobbying larded with campaign donations. Corruption, in other words.

Yet this cannot be the whole answer, for options have been given special treatment elsewhere, too: Britain's Labour government maintained tax concessions for them without donations in return. Why? Because businesses told the government this would help high-tech companies to prosper. “Picking winners”, the old delusion of British industrial policy, may have been obsolete, but if managers picked the winners for you, that made it all right.

Since Gordon Brown, Labour's chancellor of the exchequer, took up his post in 1997, every one of his annual budgets has included an array of tax breaks and other incentives for particular industries. Businessmen have been given prominent positions advising government, or even in it: Lord Simon, the former head of the BP oil giant, for example, or Lord Sainsbury, formerly of the eponymous retailer and now science minister, or Lord Haskins, who ran a task force dedicated to cutting red tape (his place has now been taken by another businessman, David Arculus). Labour should no longer be hostile to business, runs the party line; it should be friendly with it.

In France, close ties between senior businessmen and government have been endemic for decades, in part for corrupt reasons (as shown by the trial now under way of former executives of Elf-Aquitaine, an oil firm used for nefarious purposes by people close to the late François Mitterrand), in part because the line between civil servants, politicians and top managers is blurred—the same people move easily between the three roles.

In Germany, Gerhard Schröder has been cast in the part of rescuer of business, propping up the Holzmann construction firm, for example. Like his predecessors, he has maintained big subsidies to Germany's inefficient and heavily polluting brown-coal industry. He also employed a businessman to recommend changes to the country's labour laws: Peter Hartz, personnel director of Volkswagen. Helmut Kohl, Mr Schröder's predecessor as chancellor, made frequent visits to China, mainly with German businessmen to help secure them contracts. Japan has long had what is known as an “iron triangle” connecting big business, the bureaucracy and the ruling Liberal Democratic Party; and, as in the American Congress, Japanese parliamentarians develop expertise in particular areas of spending or regulation in order to attract corporate donations.

No one could easily overlook the representation of business in George Bush's White House, from John Snow, the treasury secretary, whose huge pay packets were mentioned earlier, to Donald Rumsfeld, the defence secretary, and Dick Cheney, the vice-president. The heads of the air force and navy were both recruited from defence firms despite—because of?—their huge budgets for procurement from those very firms. Of the 200 or so known members of Mr Bush's leading fund-raising group, known as “the pioneers”, more than 40 have been given jobs in government. When Mr Cheney ran a task force to recommend changes in American energy policy, he naturally consulted a lot of big energy firms, most embarrassingly Enron. No doubt it was entirely coincidental that his report recommended subsidies and incentives to increase domestic output of energy—by American energy firms.

What can be and is easily overlooked is that the American government, despite its supposed reckless market-fundamentalism, actually spends more than $90 billion of the federal budget each year on hand-outs to business: farm subsidies (which mainly go to agri-businesses, not farmers), research grants, export-credit guarantees, incentives of many kinds. Moreover, that figure, calculated by the Cato Institute, a Washington think-tank, is certain to be an under-estimate, as the true extent of what such critics call “corporate welfare” is not disclosed. Other rich countries do the same, especially for agri-businesses, but not only those. In 2000, export-credit guarantees outstanding from the 30 OECD members totalled $330 billion.

American government spends more than $90 billion of the federal budget each year on hand-outs to business

The interventionist itch

What is wrong with all this? Surely, now that it is agreed that socialism doesn't work and that direct government ownership is usually disastrous, politicians should work closely with businessmen? After all, they are the ones who know how to make things happen and to create jobs.

They are. But that is what, as far as possible, they should be left to do, in competition with one another and at arm's length from government. The job of a chief executive is to make profits for his company and, no doubt, feather his own nest; it is not to make public policy—especially in his own industry, for that is where his selfish interests will be greatest. Inviting him to advise government, or listening to his views about promoting share options to help his industry, is sure to divert public policy to private ends. This is not the fault of executives or their companies; it is the fault of government.

Ministers and business bosses do, of course, share some goals: they both want faster economic growth, and they often both want jobs to be created or, in the common political parlance, “protected”. So the urge to co-operate is powerful, by ministers acting as salesmen abroad or slanting regulations, tax breaks and subsidies to promote desired outcomes at home. It is not always corrupt or self-serving or

distorting, and is often done with honourable motives. But it still ought to be avoided, for five main reasons.

The urge for business bosses and ministers to co-operate is powerful but ought to be avoided

The first is that, far more often than not, the outcome is bent to selfish ends. Adam Smith wrote in the 18th century that trade regulations “may, I think, be demonstrated to be in every case a common piece of dupery, by which the interest of the State and the nation is constantly sacrificed to some particular class of traders.” The same applies to many regulatory and fiscal measures. Once established, such measures become perilously hard to change, for the beneficiaries fight to keep them.

The second is also shared with trade protection. It is that even if such intervention might be justified on some economic ground or other, governments do not have the knowledge or competence to be able to direct it properly, in terms of quantity, character and timing. That is why governments often end up seeking businesses' advice, which returns us to the previous problem.

Third, interventions are never neutral. Money or privileges are given to one group at the expense, directly or indirectly, of others or of taxpayers in general. Even within an industry, the interests of the firms consulted may differ from those of other firms. Efforts to even things up just add to the costs. And domestic interventions distort international competition just as much as do tariffs. One of the greatest achievements of the European Union has been to agree to limit and in many cases entirely forbid state subsidies in member countries, for exactly that reason. But the task is incomplete.

Fourth, all fiscal and regulatory interventions are an invitation not only for lobbying but also for outright corruption. That, it must be admitted, is why some politicians like them: they provide the leverage with which to extract political donations.

Fifth, and perhaps most fundamental, is the related fact that close ties between business and government are detrimental to democracy, and to public trust in democratic government. Companies pose a problem for democracy by their very existence, for through their command over resources, persuasive power and many legal privileges (such as the limited liability that is the basis of joint-stock companies), they unavoidably carry much more political weight than do individual citizens. Similarly, political equality is challenged by extremes of wealth, for with more money may come more political power. Both inequalities have to be tolerated because they bring social advantages too, but there are limits. In democracies, governments have to be the arbitrators, the counterweights to powerful private groups. But if they allow, or even encourage, companies and wealthy individuals to manipulate them, they risk stretching public faith in democracy to breaking point.

At least Sisyphus tried

Needless to say, governments will always deal with businesses. They will always want to, to some extent, and their taxes, spending and regulations will mean that they always have to. Individuals and companies will also always offer financial and other support to political parties, and will seek, on their own or in groups, to lobby governments in support of their interests. So, whereas entirely free trade may in principle be attainable (though it remains a distant prospect) because the bargaining in governments' trade deals could go all the way to zero, the complete detachment of governments from business, lobbies and donors is not.

Pushing back the extent of influence is destined to be a never-ending effort, particularly when the influence-taking gets out of hand, as it did in most rich countries (especially America) during the late 1990s. Competition and choice are the market processes that bring long-term, broadly based benefits to the public, and political influence or favouritism constantly threaten to disable those processes.

There is no single, big solution to campaign-finance abuse, interest-group influence or corporate privileges. As Mr Rauch wrote in his 1999 book “Government's End”, what is needed is a panoply of incremental changes: pressure to scrap corporate welfare; reforms to make tax systems neutral rather than preferential; more use of competitive contracts for public programmes to discourage their capture by particular interest groups; a stronger antitrust policy generally (this has been one of the bright spots in public policy in America, Britain and the EU as a whole in recent years); a more robust attitude by politicians to corporate pressure; more legal challenges to abuses of procedure; laws enforcing the disclosure of political donations and banning devious funding routes; laws seeking to reduce the need for campaign money by handing out free advertising time on television; and a myriad other measures.

Without that Sisyphean effort, governments will just be crushed. And so, eventually, will be the freedoms both of capitalism and democracy.

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Give freedom a chance

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An agenda for rich-country governments

THESE are melancholy times, to borrow a word from James Wilson's 1843 essay that gave birth to *The Economist*. The world's big economies are growing sluggishly, if at all, with price deflation a fact in Japan, a fear in western Europe and a danger in the United States. The brightest economic lights, in China and the rest of East Asia, have just been dimmed by fear of a new respiratory disease, SARS. The two big driving forces of the past few years, technology investment and American domestic demand, both look unlikely to provide much new stimulus any time soon. Meanwhile arguments continue to rumble over the war in Iraq, optimism about peace in the Middle East is as rare there as lush green fields, even after George Bush's recent summit in Aqaba, and al-Qaeda's terrorists have again proved themselves capable of bringing death and fear.

Yet the pessimism is overdone. Some of it is the inevitable result of fear, especially of war and terrorism. Much, though, is caused by impatience. When a financial-market boom has been as extreme as the one that took place in the rich countries during the late 1990s, and is followed by a bust as extreme as the one that started in 2000, it always takes time for economies to adjust. Excess capacity built up during the boom has to be scrapped or somehow absorbed; corporate and consumer debtors have to cut their spending and increase their saving in order to avoid bankruptcy; and those who lost billions in the crash—mainly pension funds and life-insurance firms—have to come to terms with their new circumstances.

The good news is that, unlike in previous stockmarket crashes, there have been no commercial-bank collapses to deepen the recession. This means the losses have been spread widely among many investors, mainly in America and Europe, which has reduced the pain but will probably prolong it.

The other, even better news is that the crash and slowdown in growth have not so far set off a big retreat from liberalism. There have been steps in the wrong direction, notably America's steel tariffs and extra farm subsidies, and the European Union's decision to shy away from cutting its big, trade-distorting common agricultural policy. Thanks to depressed stockmarkets and worries about jobs, privatisation programmes have ground almost to a halt in the rich countries, and deregulation in over-rigid Germany and Japan is proving painfully slow. So far, though, the political debate is not about whether to do these things but when. And the pressure from the developing world, especially China, is arguing for sooner rather than later: fast growth there and continued liberalisation are intensifying competition for many firms and, on balance, reinforcing the case for deregulation and technological innovation in the rich world.

However, as long as this adjustment period lasts, the political climate for open markets will get icier in both Europe and America. Al Gore ran on an anti-business ticket in America's 2000 presidential election, in response to the perceived excesses of pay and profits during the 1990s, and had he been a competent campaigner he would surely have won. In 2004 any Democratic opponent of George Bush will make much of unemployment, tax cuts for the rich and the failure to deal decisively with corporate wrong-

doing. Mr Bush might well be tempted to protect some more old industries against “unfair” competition, just as he already has for steel and farms, in order to lure his share of working-class votes. The same dynamic will apply to congressional races.

In Europe the idea that trade liberalisation does not help the poor and has led to growing inequality is already popular and could gain further ground. Tensions with America over Iraq, the Middle East and elsewhere have eroded the fragile support in continental Europe for what are seen as American policies of free markets and shareholder capitalism, as well as making it less likely that the EU will change its mind and agree to cut farm subsidies as part of a new round of trade negotiations in the WTO.

International politics add to that danger. The foreign policy that America has embarked upon since the atrocities of September 11th consists of a concerted attempt to solve some long-term problems inherited from the cold war and even the second world war, especially in the Middle East, which have helped make America the target of messianic terrorists. But since the solutions involve change, and change risks instability as well as conflict, that policy is causing widespread nervousness and even opposition among America's European allies. Some cack-handed American diplomacy and implementation of the policy (especially in Iraq immediately after the military victory) has not helped. Nor has an associated perception that the Americans are deserting the multilateral organisations they helped set up after 1945: the UN (over Iraq), and perhaps in future the WTO, given America's new liking for bilateral trade pacts.

The underpinnings of progress in the world remain strong, but the chillier political climate is putting that progress at risk. Some of what needs to be done to kick liberal capitalism back into acceptability has been outlined in this survey: moves to punish corporate wrong-doers and to fill the power vacuum that is leading executives to line their bank accounts; moves to separate business and government in order to preserve government's role as an arbitrator and counterweight, rather than as a corporate poodle. A wider and equally important hope is that politicians and policymakers will keep their eyes on the long-term, wealth-creating benefits of liberalism and avoid the temptations of subsidy and trade protection, which so often end up by eroding economic freedom gradually but powerfully.

The underpinnings of progress in the world remain strong, but the chillier political climate is putting that progress at risk

Hope seems a frail reed on which to rely. But there is strong evidence of the gains that liberalism brings, in terms of higher living standards and the reduction of poverty, providing ammunition for the constant and vigorous campaign that is needed if freedom is to be preserved and enhanced, and the hope fulfilled. That evidence is particularly convincing in the developing world, where Asian successes act as a fine example to others.

Where rich-country campaigners—and, even more important, rich-country governments—need to work harder is in distinguishing the real problems of the third world from those sweepingly claimed by anti-globalisation campaigners. Poverty is being reduced, thanks to globalisation, as is inequality; but neither is being reduced rapidly enough, and the process is leaving plenty of people behind. A right and proper task for liberals is to shine the light of hope on the un-globalised and un-developed parts of the world, which particularly means Africa. That is desirable in its own terms, but it would also help strengthen support for liberalism at home, which is sapped by the sight of unresolved, and in some cases worsening, poverty abroad, and the mistaken association of that in many people's minds with trade and freer markets.

The evidence from Asia suggests that the main solutions to African poverty lie in Africa itself, and particularly in its governmental institutions. Whatever the magic of markets, they cannot work effectively without the rule of law, the protection of property rights, stable and socially acceptable regulations, and stability of public finances and the national currency. Rich-country liberals can do little directly to provide those, beyond attaching incentives for their creation to overseas aid. They can, though, push for two big things which would give local activists for democracy and market capitalism in Africa a better chance of success.

The evidence from Asia suggests that the main solutions to African poverty lie in Africa itself

The first would be to press governments to double—no, treble—the sums they are giving to help fight the diseases that are plaguing so much of Africa and undermining its social and political institutions. These are, principally, AIDS, malaria and tuberculosis. The United Nations has a “Global Fund” established to channel donors' money into research and treatment for those diseases, and the strengthening of health-care systems in afflicted countries more generally, in order to supplement and co-ordinate bilateral efforts.

The value of life

In total, more than 20m people have died from AIDS already. Some 2.4m Africans died from it last year alone, and nearly 30m Africans are thought to carry the virus that causes it. Each year about 2m people die from tuberculosis (some because they also have AIDS) and at least 1m from malaria. Given that toll, you would have thought that the necessary billions would be forthcoming. They have not been.

Bilateral aid for these diseases last year amounted to about $1.2 billion. Rich-country governments have pledged a mere $4.6 billion for the UN's Global Fund since it was established in 2001 as a six-year programme. Some of that is coming from the United States, as the multilateral part of a mainly bilateral $15 billion effort expanded by President Bush in February and just confirmed by Congress, and about $2.5 billion from the EU countries—which has been rising, to match America's effort. But all these amounts, welcome as they are, remain too small for the task.

There are plenty of good reasons to doubt that overseas aid has been effective in the third world. Much has been stolen or wasted. It seems to work only when it is well targeted and monitored by outsiders, and when it is not simply a substitute for local money. Dealing with these diseases fits all those bills.

If the European Union, Japan and the United States were to treble the combined sums they donate to the Global Fund and in bilateral disease-related aid to, say, $15 billion a year, their taxpayers would have to stump up about $30 per head. That does not seem a lot for saving millions of lives and shoring up crumbling societies. Nor is it much compared with the other things on which rich countries spend their money. America shells outs $400 billion a year on defence, for instance. The 30 members of the OECD spend more than $330 billion a year on supporting their farmers, both through direct subsidies and through higher prices for consumers. Cut that by 5%, and you will have found enough money to treble the rich world's current official donations to fight AIDS.

Overseas aid seems to work only when it is well targeted and monitored by outsiders, and when it is not simply a substitute for local money

Farm support should, though, be cut by much more than 5%. Dismantling the EU's common agricultural policy, America's lavish system of farm support and Japan's protections for its domestic producers of rice and other foods is the second big thing that rich-country liberals must fight for in order to give market capitalism a chance in the poorest countries. Freeing farm trade is a wearying campaign, for it has gone on so long—160 years, indeed—and to so little effect. It is tempting to give up, accepting that lavish farm support is bound to remain a permanent feature of the developed world, and a continuing slap in the face to the farmers of Africa and the rest of the third world. That, however, would be a terrible mistake—a betrayal of the poor, in the rich countries as well as in Africa.

Making their garden grow

If farm subsidies and trade barriers were to be reduced and eventually eliminated, the biggest beneficiaries would be the developed countries themselves and especially their poorest citizens, for they spend more of their income on food than the rich do and so would gain most from lower food prices. They also suffer most from the worsening of food quality that has resulted as agriculture tries to cope with high prices, restricted trade and dear land by becoming ever more industrialised.

Farmers themselves would lose out if support were to be reduced, but mainly the bigger ones. In the EU, the largest 25% of farms get 70% of the subsidies. The CAP is an inefficient way to bolster farm incomes anyway: nearly half of the cost to taxpayers and consumers is reckoned to go into higher rents or land values. And, before you start believing the popular argument that these inducements are needed for environmental reasons, think of the pollution from fertilisers and pesticides, the loss of wildlife habitats, the heavy use of water and the high energy bills for glasshouses, all of which result from the intensive agriculture that subsidies encourage in Europe, Japan and America.

Third-world farmers would gain from reduced farm support in rich countries because new markets would open up for their produce. European farm ministers try to deny this by claiming that African produce does not compete with that of European farmers, but that is, as it were, a chicken-and-egg issue: African farmers do not compete with European ones because high tariffs and low quotas prevent them from doing so. What they would gain most of all from

Third-world farmers would gain from reduced farm support in

the opening up of agricultural trade would be choice, the chance to try to grow and sell new crops or livestock. Third-world food-processing businesses would also benefit, for the tariffs on processed food are often even higher than on the unprocessed sort.

rich countries because new markets would open up for their produce

Coffee producers, for example, are currently suffering from a big slump in prices, thanks to rapid increases in production in Vietnam and elsewhere. If more coffee farmers had the option to switch to other foods and crops that are currently protected in the rich world, or to move upmarket by processing more of their crop, the slump could be dealt with. Mike Moore, the New Zealander who has just retired as director-general of the WTO, writes of another example, cotton, in his new book, “A World Without Walls”. In 2001, American cotton producers received $3.4 billion in government subsidies, which went to a total of 25,000 farmers whose net household worth averaged about $800,000. The IMF and the World Bank reckon that removal of those American subsidies would increase the incomes of cotton-producing countries in West and Central Africa by $250m a year.

Complete liberalisation in agriculture is a remote prospect. But the process can be started, just as it has been in other sectors during the past half-century. It is supposed to be at the centre of the current Doha round of trade negotiations. Getting the process of freeing farm trade under way should become one of the great campaigns for liberals during this decade, just as the corn laws were in the early years of *The Economist*. In his polemical prospectus for his new free-trade publication in the summer of 1843, 160 years ago, James Wilson ended with these words:

> And we hope to see the day when it will be as difficult to understand how an act of parliament could have been made to restrict the food and employment of the people, as it is now to conceive how the mild, inoffensive spirit of Christianity could ever have been converted into the plea of persecution and martyrdom, or how poor old wrinkled women, with a little eccentricity, were burned by our forefathers for witchcraft.

Here's still hoping.

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Oracle versus PeopleSoft

Barbarians in the Valley

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Oracle's hostile bid for PeopleSoft will supply the best evidence yet about whether the rules of American business are changing

FANS of the raw-meat variety of capitalism are finding much to admire in Oracle's hostile bid for PeopleSoft, a big rival in the software business. There is the theatre: two sworn enemies slugging each other senseless. But there are also the growing signs that Oracle's bid may come to mark a departure from the previous rules of business in America. The business culture of the 1990s—defined, above all, by the consensual business matings that spawned the greatest merger boom in history—now looks too cosy. As agitation for system-wide reform continues, Oracle's bid is the latest evidence that managers, boards and shareholders have begun to play a less friendly game. Nobody knows what the new rules will look like. This battle may provide the first real clues.

On June 2nd, PeopleSoft said that it would buy J.D. Edwards, a smaller rival. Four days later, Oracle announced its own bid for PeopleSoft, and invited the firm's board to talk. Furious that his own plans had been endangered, PeopleSoft's boss, Craig Conway, called Oracle's offer “diabolical”, and its boss, Larry Ellison, a “sociopath”—not the worst thing ever said of the colourful billionaire also famed for his love of things Japanese and trying to win the America's Cup for yachting. Moreover, said Mr Conway, he “could imagine no price nor combination of price and other conditions to recommend accepting the offer”. On June 12th, PeopleSoft turned Oracle down. It said there was a big risk that antitrust authorities would block the merger; that uncertainty, plus Oracle's stated intention to discontinue PeopleSoft's products, would damage the company; and that Mr Ellison's $16 a share offer was too low.

Mr Conway's comments were a gift, allowing Oracle to claim that PeopleSoft's management was entrenched and deaf to the interests of its shareholders. On June 16th, PeopleSoft amended its bid for J.D. Edwards in a way that allowed it to avoid putting the matter to a vote of PeopleSoft shareholders—claiming it did so to accelerate the merger and limit the harm from Oracle's bid. Oracle said PeopleSoft was once again frustrating the will of shareholders.

Larry's art of war

On June 18th, Mr Ellison raised his bid to $19.50—and also filed suit against PeopleSoft, alleging that the board's actions, including its refusal to dissolve the firm's strong “poison pill” anti-takeover defence, breached its fiduciary duties to shareholders. Two days later, this time after “careful consideration and acting upon the recommendation of a committee of independent directors”, PeopleSoft's board again rejected Oracle's offer, for the same three reasons as before. Oracle says PeopleSoft's board has never made contact.

The first item before PeopleSoft's shareholders is the sincerity of its antitrust defence. Mr Ellison says that PeopleSoft's arguments are specious. Business software is a highly competitive market, he says, with the biggest firm, SAP of Germany, enjoying just a 17% share. Moreover, he asks, why would the authorities allow PeopleSoft and J.D. Edwards, the third- and fourth-biggest firms, to merge, but not Oracle and PeopleSoft, the second- and third-biggest? PeopleSoft responds that Mr Ellison is defining the market too loosely. In the market for software sold to large firms, it says, there are only three suppliers: SAP, Oracle and itself.

In announcing his bid, Mr Ellison said that, although he would continue to support PeopleSoft's existing software, Oracle would no longer develop future versions. That has given PeopleSoft a lot of angry customers to marshal in its defence. As one source close to PeopleSoft puts it, “software is like fish: if it stops swimming, it dies”. Eventually, customers know they will have to switch to different software, which will cost money. By itself, this does not violate antitrust law (although the state of Connecticut, which is suing to block the merger, appears to think differently). But it does create a strong motive for customers to oppose the merger.

With the Department of Justice likely soon to announce it needs more time to study the deal (a routine request, says Oracle), Mr Ellison says he is willing to be “very patient, for as long as it takes”. If that is true, the focus is likely soon to turn to PeopleSoft's anti-takeover defences, notably its poison pill and its staggered board.

Poison pills, which use the threat of a massive issuance of new shares and other complicated tactics to thwart takeovers, spread as managers sought protection from the sort of hostile takeover popular in the 1980s. Of the 5,529 publicly owned firms that Institutional Shareholder Services monitors, 2,024 have a poison pill. Staggered boards (in which directors, serving multi-year terms, get elected in different years, making it impossible to replace an entire board at once) are even more popular: 3,052 of ISS's firms have a staggered board. It would take two annual meetings to elect a majority of PeopleSoft's board. The respectable defence for these practices, sanctioned by the courts, is that they stop a “rush to judgment” during a hostile bid, an argument PeopleSoft now echoes. The counter-argument is that they entrench management, discourage takeover attempts and depress the share price.

Shareholders are becoming more suspicious of poison pills. Recent shareholder pressure on Hewlett-Packard, another west-coast technology firm, forced its board to dissolve its poison pill. A shareholder resolution asking that the firm put the creation of future pills to a shareholder vote passed this year, despite management opposition. The way PeopleSoft handles its defences could crystallise attitudes.

Ultimately, the courts in Delaware (where most American firms are incorporated) may be asked to rule on the board's behaviour at PeopleSoft. This would also be an important test of changing attitudes. Recent Delaware rulings (including sharp words for Disney's board over an obscene pay-off to Michael Ovitz, a failed former company president) suggest that its judges have begun to rethink the latitude with which they have allowed directors to exercise their “business judgment”. Delaware has a bad name, as a haven for incumbent management. But of late, say its supporters, its judges have become more sensitive to the wishes of big shareholders, and they will be listening attentively.

Mr Ellison may have to raise his offer if he wants to convince the world that PeopleSoft's management really is entrenched and calls the shots over what one Oracle adviser calls a “typical, light-weight Silicon Valley board”. Shareholders, meanwhile, will have to decide whether they need to push harder for more power. Next month, the Securities and Exchange Commission will decide whether to propose new rules giving shareholders the right to nominate candidates for directors themselves. Some institutional investors champion the idea. Most managers hate it. The SEC is also thinking of giving shareholders an annual vote on the boss's pay. That may be something to which Mr Ellison, America's unlikely new shareholder champion, needs to devote some thought. In 2001, including share options, Oracle's famously imperial boss collected over $700m.

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Internet access

Bubble trouble

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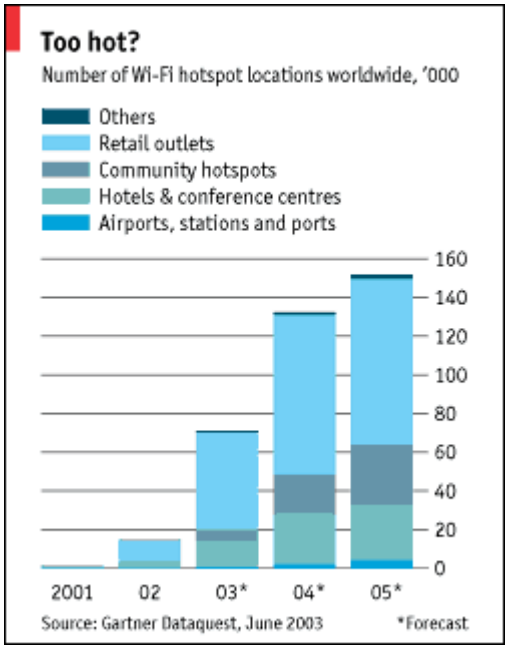
Is the "Wi-Fi" wireless internet boom about to turn into a bust?

IT ALL sounds ominously familiar. A new technology emerges and is rapidly embraced by technology enthusiasts. Hundreds of firms spring up, hoping to cash in on its expected breakthrough into the mass market. Profits, or having a sensible business model, are forgotten in the rush. But demand proves elusive, a painful bust ensues, and only a handful of firms survive. It happened during dotcom mania and is now about to happen again, albeit on a smaller scale, to Wi-Fi, a popular way to surf the internet wirelessly.



Wi-Fi is mainly used in homes, schools, universities and offices. People with Wi-Fi-capable laptops can get online via access points that can link computers within 50 metres or so to the internet. Gartner Dataquest, a research firm, estimates that 15m Wi-Fi adaptors for computers were sold worldwide last year, and 4.4m access points. Alongside this boom in the private use of Wi-Fi, many firms have rushed to set up public "hotspots" in airports, hotels, shops and restaurants, hoping to charge for Wi-Fi access.

Public hotspots are outnumbered by private access points, but their numbers are growing fast. There are expected to be more than 70,000 this year (see chart). Consortia in America, Europe and Asia have announced ambitious plans to build tens of thousands of hotspots over the next few years, even though there is little evidence of any demand for them. Meanwhile, private-equity investors are throwing money at Wi-Fi firms—over $1.5 billion since 2000, according to Rajeev Chand of Rutberg & Company, a San Francisco investment bank. In short, it all looks like a bubble. As a recent report from Forrester, a consultancy, notes, "it's as if the dotcom boom and bust never happened."

Perhaps the best-known network of hotspots is that operated by T-Mobile, a wireless operator, in over 2,000 Starbucks coffee shops in America. Around 25,000 people access the hotspots each week, which works out at an average of less than two users per day per hotspot. But the cost of connecting each hotspot to the internet is several hundred dollars a month. The Wi-Fi hotspot at Amsterdam's Schiphol airport is used by only a dozen people each day. Operators are gambling that demand will pick up as they build more hotspots—eerily reminiscent of the "build it and they will come" approach taken by many firms during the dotcom boom.

Users may be deterred by high prices. Even after a recent round of price cuts, using T-Mobile's network of hotspots costs $6 per hour, $40 per month, or $360 per year. Other operators in America charge $40-70 per month. Prices in Europe are as high as *euro*130 ($150) per month. A study by ForceNine Consulting found that demand for Wi-Fi hotspots was highly price-sensitive, and that further cuts might boost demand. Only 3% of tech-savvy American consumers surveyed said they would pay $2 per hour for Wi-Fi access, but 20% said they would pay $1. However, a subscription to one network of hotspots does not entitle you to use others, so you may need one subscription in the airport, and another in the coffee shop.

But there are more fundamental challenges facing public hotspots. The number of people who carry laptop computers around is quite small. Daniel Sweeney of Forward Concepts, a consultancy, points out that travelling businesspeople and other "road warriors" have proved an illusory market for wireless-data

firms in the past. Unless Wi-Fi is added to mobile phones, most people will not carry a Wi-Fi-capable device. And unlike a mobile phone, which can be used anywhere, any time, Wi-Fi hotspots depend on casual usage. “That's a shaky foundation for a communications business”, says Mr Sweeney.

The coming shake-out in Wi-Fi will force operators to identify which of their many hotspot locations make sense. They should concentrate on business users, advises Andrew Cole of Adventis, a telecoms consultancy. The bubble, he says, is in consumer Wi-Fi. Hotspots in coffee shops, cinemas and malls will mostly prove uneconomic. Gartner predicts that the number of hotspots in retail outlets will peak in 2005, and then decline, as uneconomic hotspots are switched off.

But for “real-estate owners, hotels, airports and convention centres, you can build a business case,” says Mr Chand. Such venues may, however, choose not to operate hotspots themselves, but instead delegate marketing, billing and roaming to incumbent telecoms firms. Either that, or they will give away free access to attract customers. Neither model bodes well for the hotspot-operator start-ups now trying to capture the Wi-Fi market.

The outlook is equally grim for the dozens of start-ups making Wi-Fi chips, systems and equipment. A few may get lucky, and be bought out by a larger equipment-maker, such as Cisco, says Mr Chand. But most will fail. Already, though sales of Wi-Fi equipment are booming, prices have tumbled, and margins are now wafer-thin. Wi-Fi will continue to spread, and will remain popular. But, rather like the internet, it may disappoint many investors who hoped to make their fortunes.

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European steel

Spot the cartel

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Despite a tough market, some steel prices have been steadily rising

THE global steel industry is in a mess. Overcapacity and weak demand have hurt steel producers. Last year, 847m tonnes of steel were produced, but consumption was only 765m tonnes. Steelmakers have responded by consolidating. Last year in Europe, for example, Arcelor, the world's biggest producer, was formed from a three-way merger of Spain's Aceralia, France's Usinor and Arbed, a Luxembourg-based company.

As a result of the merger, Arcelor has restrained production. In Europe, that has helped other big producers, such as Corus, a troubled Anglo-Dutch group, and ThyssenKrupp, Germany's biggest steelmaker. Buyers of steel, however, have been less happy. None will talk openly, fearing retaliation from their suppliers, but *The Economist* has spoken to several big European firms that are struggling to cope with steady price increases.

The chief executive of one large Italian manufacturer was especially outspoken. His firm uses more than 200,000 tonnes of flat plate steel each year, so higher input prices have nasty knock-on effects on margins. He reckons that over the past year prices for ordinary steel have risen by 15-20%, and have softened a little recently only because demand has weakened. In effect, he says, Europe's big three producers operate a cartel that controls the market, at least during periods when demand is not actually falling.

Surely that should be of interest to the antitrust authorities in Brussels? Yet unofficial complaints by buyers have gone nowhere. And few companies are willing to make their complaints official, once again for fear of retaliation.

In April the big steelmakers upped the ante once again when they said that they were increasing prices by 3-5% for some basic steel products in the second quarter. Even if analysts are right to think that, with buyers squealing, the increases are reaching their limit, hot rolled coil steel, for example, is now selling at around *euro*330 per tonne, compared with nearer *euro*200 per tonne at the start of 2002.

Things are a lot worse at the specialist end of the business. Consider tinplate steel. Although it represents only 3% of global steel production, it is a high-end product, used in particular for food and drink cans. The top ten steel firms control 53% of this market, twice the share of the top ten in total steel production. In Europe, Arcelor, Corus and Rasselstein, a German specialist steelmaker, dominate supply.

In 2001, the three firms announced coordinated price increases of 5.5%. In 2002, they said they would raise prices by up to 3.25%—and Arcelor also announced a one-off 10% price rise in some countries, to make its European pricing “more coherent” after the merger. Earlier this year, another 5% price increase was announced.

The effect of these rises was mostly to alienate customers, who complain that, as there is no obvious link between the higher prices and the costs of the steelmakers, the increases are opportunistic. A few big customers have resisted, so that the price increases actually achieved were less than those announced—more like 3%, 1.25% and 3.5% in 2001, 2002 and this year respectively. Still, even for them, prices rose by significantly more than inflation.

Even if Europe's antitrust authorities do not intervene, it is not clear that raising prices in this way is in the steelmakers' long-term best interests. In food and drink packaging, for instance, excessively high steel prices might lead manufacturers to switch from steel cans to alternative products such as

aluminium pouches.

Some customers say that the steelmakers are belatedly starting to recognise the danger, and are showing signs of a greater concern for their customers. “The problem is that the big steel companies have historically had very little knowledge about their customers,” says the chief executive of a large European manufacturer. “This is new for them.” The manufacturers are hoping the steelmakers learn fast.

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Beer in Europe

In search of froth

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A bottoms-up strategy in central Europe

HEINEKEN, a Dutch brewer, may be losing its fizz. A nasty cocktail of SARS, war in Iraq and economic slowdown prompted it to issue a profit warning on June 23rd. Still, hope springs eternal, and Heineken is turning its attention to one beer market that is growing fast. It hopes to conquer the palates of central Europe's beer drinkers.

Last month, it paid *euro*1.9 billion ($2.2 billion) for BBAG, Austria's leading beer maker, whose subsidiary, Brau Union, is a big investor in central Europe's beer market. Heineken thus replaces SABMiller, the world's second-biggest brewer, as central Europe's number one, with a 27% market share. The deal sharply boosts Heineken's presence in Romania and Hungary. A cosy oligopoly of brewing giants—Interbrew, a Belgian brewer, completes the triumvirate—now holds sway across the region.

In central Europe, beer consumption per head, at around 55 litres (97 British pints), is below the European Union average—with the exception of the Czechs, who quaff a world-beating 159 litres each of beer every year. But it is growing fast, as such traditional spirits as vodka are shunned in favour of trendier beer. Canadean, a research group, estimates that beer consumption in the region (including former Soviet states) grew by a tasty 52% between 1996 and 2001.

Yet this is not a straightforward growth play. Ian Shackleton of CSFB reckons that with average consumption in central European countries now over 50 litres a head, growth will begin to slow. So investors are starting to shift their focus from volume to profits, notably by tempting drinkers to switch from mainstream brands to premium ones. This requires extensive distribution channels and slick marketing campaigns aimed at young, aspirational drinkers. Heineken hopes to replicate its earlier successes in France and Italy by using BBAG's local network to sell its international brands, Heineken and Amstel.

Unfortunately, central Europeans, particularly beery Czechs, are notoriously price-sensitive, parochial boozers. Hefty excise duties in Poland—its taxes are a whopping *euro*22.50 per hundred litres, over twice as much as in Germany (but one-third as high as in Britain, and on a par with America)—have triggered a bout of price competition, stunting the growth of costlier premium brands. Poland's sales also suffer from tough restrictions on advertising. But the brewers are betting, even so, that central Europe's impending entry to the EU will increase consumer spending power—and with it their profits. Bottoms up to that.

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Health-care fraud

A sick business

Jun 26th 2003
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Why are so many American health-care firms caught up in fraud scandals?

Somewhere to put the ill-gotten gains

CRIME no longer pays quite as well as it did—or at least, not for health-care firms involved in cheating the American government. On June 20th, AstraZeneca, a British drug firm, agreed to pay $355m to settle federal charges that, among other things, it gave free samples of its cancer drug, Zoladex, to American doctors, to curry favour, knowing that these same doctors were billing the government's Medicare health insurance scheme for unwarranted reimbursement.

This week brought further evidence of firms playing fast and loose with public cash. The Department of Justice said it would join civil fraud lawsuits against Medco, a pharmacy-benefits manager owned by Merck. These allege, among other things, that Medco's dodgy fulfilment of mail-order prescriptions may have led to excessive charges for drug orders for federal employees, whose bills are covered by the government. On June 24th, Pediatrix Medical Group, America's largest network of neonatal and maternal-health specialists, said it is under investigation for irregular billing of Medicaid, another government insurance programme.

Such developments are but the latest in a veritable rash of health-care shenanigans. In April, GlaxoSmithKline and Bayer, two large drug firms, agreed jointly to pay $345m to settle allegations of defrauding Medicaid through excessive pricing for certain drugs. Tenet, America's second-largest hospital chain, last month lost its chief executive on the back of a number of scandals, and faces a DOJ lawsuit for allegedly overcharging Medicare for certain procedures. HealthSouth, America's biggest provider of outpatient surgery and other health-care services, already buckling under accusations of accounting fraud, is also under scrutiny for allegedly billing Medicare and Medicaid for millions of dollars of services that it never delivered.

Although this is inevitably guesswork, the National Health Care Anti-Fraud Association, in Washington, DC—representing various private and public anti-fraud bodies—reckons that 3% of America's total health-care spending (which was $1.4 trillion in 2001) may be lost to fraud.

Why are things so bad? Of course, there is nothing new in firms trying to milk money out of massive government programmes. The federal government spent a hefty $249 billion on Medicare last year; it shared with state governments a comparable cost for Medicaid. Both programmes have byzantine billing systems that are ripe for fiddling.

What has changed is better detection of fraudsters, in part due to greater pressure to find them as health-care costs and government deficits both soar. While federal spending on fighting health-care fraud is under $100m a year, government recovery of ill-gotten gains rose to $1.2 billion in 2001, according to a new report by Taxpayers Against Fraud, a lobby group. The recovery trend is likely to continue upwards.

The government started small, pursuing medical laboratories, then moving on to hospitals (notably Columbia/HCA) and nursing homes. Drug firms are the latest target—and not the last. Erik Skramstad, of PWC's investigations division in Boston, expects the government next to pursue clinical research centres funded by the likes of the National Institutes of Health.

Whistleblowers are the government's secret weapon. Under the False Claims Act (FCA), a federal law

revamped in the 1980s primarily to clamp down on fraud by defence contractors, whistleblowers can file a lawsuit without a defendant's knowledge, until the DOJ has decided whether to join the case.

This veil of secrecy may encourage employees of a guilty company to come forward without fear of immediate reprisals. But what is really bringing whistleblowers out of the woodwork, according to Mr Skramstad, are the generous rewards offered by the FCA: up to 20% of the total fine levied. Douglas Durand, a whistleblower in AstraZeneca's case, as well as in an earlier Medicare fraud suit against TAP pharmaceuticals, has netted himself $125m in awards. America's trial lawyers, seeing a juicy opportunity, are now aggressively soliciting whistleblowers.

Jack Meyer, head of New Directions for Policy, a Washington think-tank, argues that more states should pass a local FCA to help clamp down on fraud in Medicaid, where prosecutions lag behind Medicare. He also thinks that something like the FCA might help America's private payers—big employers and managed-care plans—that also suffer from dodgy billing, but can only fight back with other civil remedies. Even without that, it seems certain that there will be many more fraud scandals before health care is cured of its vices.

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Women

Be a man

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Men compete harder than women. That is why they do better at work

HOW to get more women to the corporate summit? After years of equal opportunity, female bosses such as Hewlett-Packard's Carly Fiorina and Xerox's Anne Mulcahy remain rarities. Women, according to a survey by Catalyst, a lobbying group, now hold nearly twice as many senior management positions in big American firms as they did in 1995—but the percentage is still only 15.7%.

In Britain, things are no better. A recent report by Laura Tyson, head of the London Business School and a former chairman of America's Council of Economic Advisers, notes that 30% of British managers are female. But many are in the "marzipan" layer just below the top-executive icing, from which non-executive directors are rarely picked; or else in such unfashionable areas as human resources. Women account for only 11% of non-executive directors of the largest, FTSE 100, firms; 8% at FTSE 250 firms; and fewer than 4% at small quoted firms.

Ms Tyson suggests casting the recruitment net wider, and also drawing more non-executives from professional services, where women do better than in corporate management. But why do women so rarely reach the boardroom? The Catalyst survey, published in the latest *Harvard Business Review*, finds that senior managers agree that the big problem is women's lack of line-management experience. In *Fortune* 500 companies, 90% of senior line managers are men.

Why don't women get such jobs? One reason may be that they view work differently to men. New research* by Catherine Hakim of the London School of Economics finds that men are three times as likely as women to regard themselves as "work-centred". Women want opportunities, but not a life dominated by work.

But research by economists at two American universities suggests that, even in the job market, women behave in ways that disadvantage them. At the University of Chicago's business school, Uri Gneezy and a group of colleagues have used novel techniques to show that women and men have different attitudes to competing. In one study that is about to appear in the *Quarterly Journal of Economics*, groups of students were paid to solve simple maze problems on a computer. In some groups, everybody was paid 50 cents per problem solved; in others, a payment of $3 per problem went only to the individual who solved most mazes. Female performance was much the same in both groups; but in the second lot, the average man did about 50% better than in the first.

A second study, of physical tasks, showed similar results. When nine- and ten-year-old children ran a race alone, boys and girls clocked similar speeds. When children raced in pairs, girls' speed hardly altered. But boys ran faster when paired with a boy, and faster still when racing against a girl. Mr Gneezy points out that, if men try harder when competing, they will disproportionately win the top jobs, even when to do the job well does not require an ability to compete. Job selection is itself highly competitive.

Linda Babcock of Carnegie Mellon University finds that women may do worse than men even when they win a job, because they take a different approach to negotiation. Ms Babcock, who recounts her studies in a forthcoming book†, noticed that male graduates with a master's degree from her university earned starting salaries almost $4,000, or 7.6%, higher than female students. But when she asked who had simply accepted the initial pay offer and who had asked for more, only 7% of women, compared with 57% of men, turned out to have negotiated. On average, those who negotiated raised the initial offer by $4,053—almost exactly the difference between men's and women's starting pay. Ms Babcock felt some exasperation because, "I teach negotiation here, and I'm always telling students to negotiate."

A laboratory study confirmed her findings. With her colleagues Michele Gelfand and Deborah Small, she

advertised a payment of between $3 and $10 for students who would play four rounds of Boggle, a parlour game. At the end, hired actors posing as experimenters said to each student, “Here's $3. Is that okay?” Astonishingly, nine times as many men as women tried to negotiate for more.

Most studies of negotiation, Ms Babcock points out, miss such findings because they do not consider why it is that people start to haggle. She suspects that women feel uncomfortable with negotiating because they think it inappropriate, or do not feel that they are entitled to ask for more money, or think it may damage a relationship with an employer. Instead, they feel unhappy and resentful when they see men ask for and receive better treatment. But “this is a lightbulb issue,” she says: when she tells women what men achieve by negotiating, they are more likely to ask too.

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*Published in “Choosing to be Different: Women, work and the family”, by Jill Kirby. Centre for Policy Studies.

† “Women Don't Ask: Negotiation and the Gender Divide”, by Linda Babcock and Sara Laschever. Princeton University Press, October 2003.

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Hooters Air

Hostess with the mostest

Jun 26th 2003
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A hawker of breasts and wings enlarges its brand

AP

Another iced water, sir?

HOOTERS restaurants have become something of an American icon. The 20-year-old chain, which prides itself on burgers, beer, and spicy chicken bits served by busty lasses in form-fitting tops and short shorts, is now offering its unique style of service in the sky. Hooters Air started flying in March between Atlanta and Myrtle Beach, South Carolina, a middle-class resort featuring sun, surf, and several of the chain's outlets. It has since added routes to Washington, DC, and New York.

Recent pain in the airline industry has helped the fledgling carrier to take off. When Vanguard, a small American airline, went bust last year, it left Myrtle Beach, home to Hooters' founder, with one fewer airline. Although a bid for Vanguard failed, he picked up a charter airline, Pace, on the cheap, fitting out two Boeing 737s with extra leg room and Hooters' distinctive bulging-eyed owl logo slapped on its tail.

Each Hooters flight is staffed by “Hooters Girls”, whose attire could be considered risqué only in the most isolated parts of America. Even so, using female “sex appeal”, for which the firm makes no apology, is something abandoned by other airlines since the 1970s.

Back then, with fares regulated, airlines competed on everything from steaks cooked-to-order to stewardesses' hemlines. Southwest Airlines, now America's leading discount carrier, got its start with ads that pushed its flight attendants' micro mini-skirts. Those days are long gone: after losing a lawsuit two decades ago over its “hot pants” uniform, Southwest's attendants tend now towards neatly pressed unisex khakis.

Indeed, Hooters has been attacked by regulators and private lawyers for its restaurant hiring practices (namely, its refusal in the face of all common sense to let men, undoubtedly eager for the job, become Hooters Girls). So far it has prevailed, but its experience has chastened its approach in the air: Hooters makes clear that cabin service is run by professional flight attendants, with the Hooters Girls as an additional perk.

More seductive than using sex to sell seats is the airline's economics. Hooters' niche is not an obvious threat to America's big airlines or their discount rivals. But its business model might be. Michael O'Leary of Ryanair, Europe's fastest growing discount airline, has predicted that airlines will be paid by cities and businesses to fly passengers free. That future may already be here. Rather than a profit centre in its own right, Hooters Air is more akin to a marketing expense, building the Hooters brand. If airline seats

increasingly become promotional giveaways, big airlines may have a lot more to fear than a little silicone.

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GPS and Galileo

Navigating the future

Jun 26th 2003
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How America can learn from Europe

ONE is a state-owned monopoly, financed by taxpayers and free at the point of consumption. The other uses private finance, promotes competition and seeks payment for services rendered. So which is American and which European? Wrong. The commercial model comes from the Europeans.

The comparison is between the Global Positioning System (GPS), developed by America, and the incipient Galileo satellite navigation system being built by the European Union. America cannot understand why the Europeans feel the need to re-invent this wheel. But apart from a desire to exercise its sovereign right to maintain its independence of America in such an important strategic area, Europe also has a business case for investing over $3 billion.

A forthcoming study in *Foreign Affairs* magazine, led by David Braunschvig, a managing director of Lazard, an investment bank, compares the two approaches to satellite navigation. It concludes, surprisingly, that America should now emulate Europe's more commercial attitude.

The aerospace business is often unusual, but the satellite business is even weirder. GPS has become indispensable for soldiers, pilots, hikers, yachtsmen, even bankers, ever since the American Department of Defence started filling the sky with satellites about 25 years ago, in order to improve navigation for fighters, bombers and warships. More recently, GPS has allowed the development of precision-guided weapons, the smart bombs that home in on targets: between Serbia four years ago and this year's Iraq war, the proportion of such bombs used rose from no more than 3% to at least 60%.

After spending $20 billion, the Pentagon has built a global system that is a key ingredient of NATO defence. But it is also an essential prop to countless civil applications: for every military user, there are now 100 civilian users. GPS provides not only satellite-navigation systems in cars and boats; it is used by internet service providers, by banks and by surveyors. One day it might be used by air traffic control systems to permit “free flight”, in which pilots of commercial aircraft find their own route and stay clear of other aircraft, without the cumbersome business of radio telephone contact with controllers on the ground. The two rival manufacturers, Boeing and Airbus, are for once collaborating to press the case for such a system upon their governments.

America used to offer only a degraded service for non-military users, until it developed jamming systems that prevented an enemy using it against the United States. In 2000, President Bill Clinton decided to open the whole service to any user. Since there was zero marginal cost, the Pentagon had handed a gift to the world. But now GPS needs more spending to upgrade it to handle applications in which lives could be put at risk, such as in air traffic control. Mr Braunschvig argues that it is time for the Americans to re-examine how they finance GPS and to relaunch it as a commercial service.

He suggests that the Pentagon hives off the military version and develops a separate commercial system to compete with Galileo. In an emergency, they could act as back-up for each other. At the moment, the commercial services based on free access to GPS have revenues estimated at around $12 billion, with no return to the American government. In the 16th century Galileo proved both Aristotle and the Catholic Church wrong in their views of the laws of physics. How fitting that statist Europe should challenge America on its odd exception to its usual free-market rules.

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Entrepreneurship

One-yen wonders

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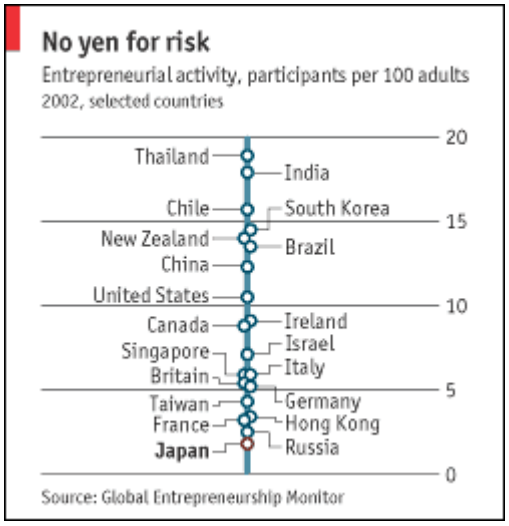
Japan discovers that countries cannot legislate for entrepreneurs



DEFLATION is a wonderful thing. A mere 50 yen will now buy you a hamburger in Tokyo. And a single yen—less than an American cent—can get you an entrepreneur.

A new law, sponsored by the Ministry of Economy, Trade and Industry (METI), makes it possible to found a business in Japan with capital of just one yen (excluding registration taxes of around ¥250,000 ($2,100)). In an effort to reinvigorate their catatonic economy, the bureaucrats are exempting start-ups from old rules that required big joint-stock companies to have at least ¥10m of capital, and even small limited-liability firms ¥3m. The exemption lasts for five years.

Japan has always been better known for improving on other people's ideas than coming up with its own. But its government seems, at last, to have grasped the connection between Japan's miserable showing in international entrepreneurial rankings (see chart) and its economic malaise (though a very high proportion of entrepreneurs can sometimes be a sign of structural problems for bigger companies, as in Thailand). With many Japanese firms being outgunned by South Korean and Chinese rivals, both on cost and increasingly on quality, the government is emphasising innovation and flexibility.

Some entrepreneurs are rising to the challenge—thanks in part to higher unemployment and longer living. Several new entrepreneurs are over Japan's traditional retirement age. One entrepreneur has begun a pet-cloning business to cater to a growing number of Japanese women who are fonder of their cat or dog than their man. A 61-year-old former golf-course manager is embarking on a second career to develop a better turf on which to play his favourite sport. Others are trying their luck as computer programmers, consultants and travel agents. There is even the odd aspiring used-car salesman.

Yet between February 1st, when the new law came into force, and June 6th, there were only 3,099 applications to start a new company. This annual rate of less than 10,000 falls far short of the ministry's goal of doubling the number of company formations to 360,000 a year by 2006.

Cutting the minimum capital requirement is a small positive step. But Japan is littered with barriers to risk-taking and innovation, from an archaic education system that fosters rote learning to bureaucratic impediments such as restrictions on firing workers. Japan's social system is based on acceding to group wishes and not displaying too much individuality. So it takes a brave Japanese to go and found a business. Alas, it may take more than bureaucratic fiat to transform Japan into a hotbed of entrepreneurial activity.

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Face value

The mediocre middle

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Sir Peter Davis is failing to save Sainsbury, perhaps because it is in terminal decline

WHEN Sir Peter Davis became chief executive of J. Sainsbury in March 2000, he was hailed as a saviour. When he had left the firm, 14 years earlier, Sainsbury was one of Britain's greatest businesses, a national supermarket chain that combined quality with value—as reflected in its "good food costs less" motto. Run by a family that cared about social principles and good governance, Sainsbury was studied by management gurus and patronised by every middle-class family. By March 2000, the chain was in crisis: profits and margins were falling. Under David (now Lord) Sainsbury and Dino Adriano, the two previous bosses, Sainsbury had lost market leadership to its arch-rival, Tesco. Sir Peter, who left because he felt the Sainsbury family would never give him the top job, had run Reed International and Prudential insurance successfully—helping the Pru, another iconic British firm, recover from a (pension mis-selling) crisis of its own. Surely he would now save Sainsbury.

A little over three years later, those hopes are dashed. Instead of admiration, Sir Peter attracts criticism. Investors grumble about his recent award of extra shares worth £3.9m, and about the board's decision to make him chairman next March, in defiance of the principles of corporate governance recommended by Derek Higgs. The share price has lagged its sector by 17% since Sir Peter arrived. Its best fillips these days come from rumours that it may be the target of a (once unthinkable) takeover bid.

By some typical metrics of corporate turnaround, Sir Peter has, in fact, done a half-decent job. He has raised profits in each of the past two years. He has slashed costs—savings are on course to reach £960m by 2005, above the original £700m target.

Yet if you want to be Britain's top retailer, that is not enough. Sainsbury has continued to lose market share. Morale at the firm was hit hard by figures for the 12 weeks to May 25th, which showed that Sainsbury's market share had fallen from 17.5% to 16.8%, while Tesco's hit a high of 26.7% and that of Asda, owned by Wal-Mart, the world's biggest and most aggressive retailer, had risen to 16.3%, threatening to pip Sainsbury as number two. While Tesco's same-store sales (ie, excluding new store openings) are rising, analysts fear that at its annual meeting on July 23rd, Sainsbury will reveal a fall during its latest quarter of 3-4%.

Another blow, albeit more expected, came on June 24th, when Britain's competition regulator hinted that Sainsbury (like its two main rivals) would not be allowed to pick up market share by buying the struggling Safeway chain.

All these problems come despite Sir Peter having invested up to £2 billion to modernise stores, supply chains and IT infrastructure. Arguably, there has been too much investment in stores in the south of England, and too little investment in genuine innovation to update areas such as the bakery and delicatessen counters that shoppers see. And the company has failed to build up non-food sales, which account for 13% of Sainsbury's turnover, compared with 18% at Tesco and a fifth at Asda.

Good food costs less elsewhere

But Sir Peter's most controversial decision has been to ignore the widespread criticism that the store is expensive. Today, in Britain (as in America), the key to success for modern retail chains is to compete

either on price (Tesco, Asda/Wal-Mart) or on really high quality (Waitrose), not to be somewhere in between. Customers who would once have come to Sainsbury for occasional exotic fare and decent quality now take those things for granted.

Ira Kalish, a management consultant at Deloitte Touche Tohmatsu, argues that “price is vital in mass retailing today—which is why Wal-Mart is so dangerous.” Although Sainsbury's prices are actually not much above those of its competitors—some 2% more than Tesco and 5% more than Asda—the perception is different. Thanks not least to years of management talk about “quality leadership”, Sainsbury is viewed as expensive. As UBS Warburg points out, Sainsbury's “long heritage of leadership on quality actually works against it.”

Sir Peter, a marketing man by trade, could have tried to change that perception. But in the late 1990s, before he arrived, Sainsbury had already attempted it—and had failed. Expensive price cuts did nothing for sales. Instead, he reinforced the idea of quality, barely mentioning price, either to staff or to the City.

Outsiders wonder if Sir Peter has the feel for the customer that a great retailer needs. John Sainsbury, the family scion who ran the firm in the 1970s, did: he could pass a shelf of goods and see at a glance if their price was wrong. So does Sir Terry Leahy, the boss of Tesco, the store that has gained most as Sainsbury has fallen. Sir Terry, like Sir Peter, comes from modest origins in Merseyside, but whereas the quiet, lean Sir Terry still collects visitors personally from the lobby of Tesco's shabby headquarters in Cheshunt, the charismatic, rotund Sir Peter directs Sainsbury's fortunes from a glass-and-steel office block in central London and seems most at home at the Royal Opera House, where he is a director. As one investor, with a taste for stereotyping, puts it: “Sir Peter is not in touch with shoppers north of Watford, who want cheap, white bread, not gourmet olive oil.”

In fact, that encapsulates Sainsbury's dilemma. Can a mass-market retailer successfully sell both gourmet olive oil to City analysts in London and white bread north of Watford? For the moment, Tesco is doing it. But Sainsbury fails to deliver a superior offer on any count: not price, not range, not quality. To move upmarket, ignoring market share and pursuing margins, would mean abandoning vast swathes of the country. But it may be even harder to compete on price alone.

Sir Peter admits that 2003 is “critical” for Sainsbury. He, or perhaps his successor, may conclude that this area of retailing is overpopulated with better-run rivals, and that Sainsbury—like Safeway—has no future as an independent business.

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Germany's Landesbanks

Gone—and going?

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WestLB's boss, Jürgen Sengera, has paid for his indulgence of a flashy London unit, headed by Robin Saunders. More troubles loom for Germany's state banks

A PAYOFF of *euro*3.25m ($3.75m), but not a word of thanks, came Jürgen Sengera's way on June 23rd, when his supervisory board ousted him as executive chairman of WestLB, Germany's most aggressive publicly owned bank. The board's decision followed a damning report by BaFin, Germany's financial regulator, on the shoddy control by WestLB of its principal-finance unit in London. BaFin has forwarded documents to the state prosecutor's office in Dusseldorf, WestLB's home city. The possibility of criminal liability will now be examined.

The proximate cause was a single bad deal, credit exposure to Boxclever, a British TV-rental firm, for which WestLB last month took a belated, extra *euro*430m charge on its 2002 accounts. The bank's delay in pinpointing the loss, not the loss itself, troubled BaFin, according to sources close to WestLB. BaFin also considered how co-investment by employees in companies borrowing from the bank was handled. Andreas Seibert, the board member who until this year had been responsible for overseeing the London unit, went along with Mr Sengera. Adolf Franke, the chief risk officer, who is already 61, might not have his contract renewed next year.

Meanwhile, Robin Saunders, a Texan who runs the principal-finance unit and who until a few months ago was the subject of a string of fawning newspaper profiles, is still in her job. However, the unit's portfolio will not be added to, and it will eventually be sold—some of it, possibly, to Ms Saunders and her colleagues.

It seems that Mr Sengera ran foul of the regional savings banks and welfare associations that own over 50% of WestLB's parent, Landesbank Nordrhein-Westfalen, (Landesbank NRW) and dominate the supervisory board. On June 23rd Mr Sengera demanded, but was denied, the board's confidence in his strategy to maintain the bank as a significant participant in international markets. The savings banks, it seems, would like to shrink WestLB back to its original role as a Landesbank (state bank), acting as their central bank and source of wholesale financial services.

This would reverse more than two decades of expansion under the previous chairman, Friedel Neuber, and two years of restructuring under Mr Sengera. Last year the bank was revamped to comprise a holding company with a state guarantee, Landesbank NRW, which owns a joint-stock commercial bank,

WestLB. WestLB took on, and continued, the group's international and investment-banking activity. Like other investment banks, it has been cutting costs: operational costs were reduced by 15% last year, including a 10% cut in staff expenditure. Results for the first five months of this year have been an improvement on last.

If the savings-bank faction on WestLB's supervisory board prevails, a reversal of strategy may be signalled as early as July 2nd, when the board next meets. The same faction was happy in the past to approve the risks and enjoy the rewards of WestLB's often aggressive foreign adventures. That has meant eating losses from loans to Mexico and Russia, as well as to the likes of Enron and WorldCom. On balance, however, WestLB has produced better returns over the years than it probably would have managed as a stay-at-home Landesbank.

But now there is a dilemma. The German market is overbanked and horribly fragmented. For years the publicly owned banks have been able to undercut their private competitors because their borrowings enjoy a state guarantee and are therefore cheaper. Such financing has enabled WestLB to undertake some of its exotic adventures. But because of changes forced on Germany by the European Union, after 2005 any debt that the public banks issue will not have state backing; existing debt will lose its guarantee in 2015. So the Landesbanks are under pressure from rating agencies and financial counterparties to demonstrate that they have profitable and sound underlying businesses.

They are beginning to be judged purely on the value of their risk-based assets and liabilities. Fitch, a rating agency, gives the debt of all Landesbanks a top, AAA grade. Recently, though, it has also rated them as if they had no state support: WestLB, its Bavarian counterpart, Bayerische Landesbank, and Sachsen LB, an eastern German newcomer, came off worst, with C/D. The best were Landesbank Baden-Württemberg (LBBW) and DekaBank, the fund manager for the savings banks, with a still mediocre B/C. This is a taste of how things will be after 2005.

Every Landesbank has tried to adjust its ownership structure to prepare for the new rules. The separation of Landesbank NRW and WestLB was one such move. Most recently, the Landesbank in Hamburg merged with its neighbour in Schleswig-Holstein to form HSH Nordbank. However, only two Landesbanks have any significant retail business, which Fitch (among others) sees as the route to more stable earnings. These are LBBW, which is half-decent, and Bankgesellschaft Berlin, which is in a terrible mess, having been laid low by a property scandal three years ago. Others, such as Landesbank Hessen-Thüringen, known as Helaba, are trying to build closer relationships with their regional savings banks. But a takeover of savings banks by Landesbanks, although a fine idea, would probably be blocked by the savings banks: they see themselves as the mothers, not the daughters, of the Landesbanks which they partly own.

Germany's banking landscape tends to change only slowly. Its financial regulators and prosecutors rarely rush either. It may be months before BaFin reacts to, or even divulges, the contents of its report on WestLB. It may be years before the Dusseldorf prosecutor brings charges, if it ever does. Meanwhile, WestLB's motley owners have to pick Mr Sengera's successor, who will have to cope with the conflicting political and economic interests of the bank's shareholders, a rising cost of funds and a declining credit rating. No queue of candidates is forming. Those approached so far, such as Andreas Treichl, head of Erste Bank in Austria, have declined.

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Freddie Mac and Fannie Mae

Crony capitalism

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Time to overhaul the regulation of America's giant mortgage companies

THIS week, America's Congress began hearings on the regulation of the country's two mortgage giants, Freddie Mac and Fannie Mae. Richard Baker, chairman of the relevant committee and a long-time critic of both companies, declared on June 24th that the present watchdog, an obscure body called the Office of Federal Housing Enterprise Oversight (OFHEO), is not up to the job. Better, he thinks, to hand the task to the part of the Treasury that supervises thrifts (building societies). He is not fussy about details, he says: all that matters is that Fannie and Freddie be scrutinised by a regulator with real authority, independent funding and competence.

A dull change in a dull corner of financial regulation? No, for the consequences may be profound. Fannie and Freddie dominate America's gigantic mortgage market. Just about every mortgage that fits their criteria—less than $322,700, with a fixed coupon—passes through their hands. That amounts to about half the total value of the market. They have enormous clout across debt markets as a whole. In recent weeks, however, an accounting scandal has cost Freddie Mac three top executives and has turned the mortgage companies from the arcane obsession of a few financial types into a big political issue. Congress, hitherto only too willing to overlook Fannie Mae's and Freddie Mac's faults, is joining the companies' critics.

Past efforts to shine a light on Fannie Mae and Freddie Mac have led nowhere. OFHEO has to grovel annually before Congress for meagre funding. Risk-control systems were introduced only in 2002, after years of delay and after Fannie and Freddie had lobbied effectively to gut tough proposals. The pair are subject to far weaker disclosure standards than other banks in similar lines of business.

Why have the mortgage companies had such an easy regulatory ride? One reason is that their sheer importance in the debt markets has made even big Wall Street firms, whose regulators are somewhat more demanding than the OFHEO, wary of crossing them. Another is that Fannie Mae and Freddie Mac have given investment banks every reason not to complain. The two are among the biggest contributors to investment-banking revenues: in debt underwriting alone, they are responsible for 30% of dollar volumes, according to Thomson Financial Services, a data collector. No other company comes close. Their debt issues, says Thomson, generated $652m in commissions last year. Fannie Mae and Freddie Mac are also huge buyers of securities and derivatives, meaning still more commissions.

Nor have congressmen had much cause to grumble. Fannie Mae in particular is reputed to be brilliant at defusing political risk. It spends millions of dollars a year on lobbying, refers deftly to “communities” and “investment”, and often announces its initiatives under the gaze of a beaming congressman. Both companies have large charitable foundations. In 2002, Fannie Mae's distributed $38m in grants. Freddie Mac's handed out $29m in 2001 (the most recent year for which figures are available). Much of the money went to groups dear to congressmen's hearts.

America's long litany of corporate scandals has changed all this. More companies are coming under scrutiny, especially if they have large debts, are exposed to the capital markets and have perplexing accounts—like Freddie Mac and Fannie Mae. Unease has been growing since last year, when the sharp drop in interest rates, and the consequent rush to refinance mortgages taken out at higher rates, left Fannie Mae with a mismatch between its debt obligations and its revenues from mortgage bonds.

The worrying intensified when the three Freddie Mac executives departed earlier this month in connection with an internal audit that is still going on. The company has since admitted that it has undercounted its profits for the past three years by $4 billion. In the past week or so, *Grant's Interest Rate Observer*, a newsletter, has argued convincingly that figures in Fannie Mae's own accounts brought its reported

earnings into question. Mr Baker's colleagues in Congress have begun asking him what could be done. “It never happened before,” he says.

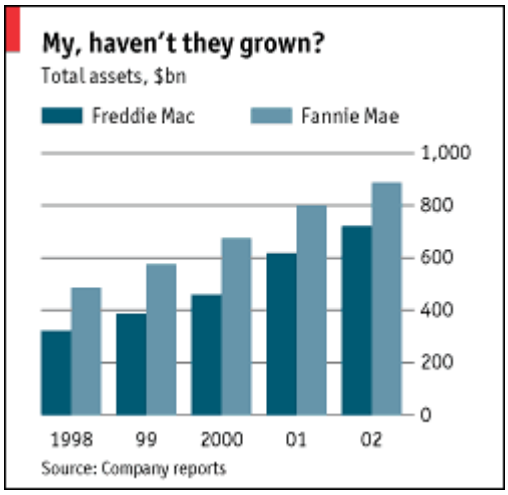
Theoretically, the two companies should not be a source of concern. Their core business consists of buying mortgages from banks and pooling them into bonds to be sold or held. Both companies guarantee the creditworthiness of these bonds, but not the interest-rate risk. They hedge their own exposure to interest-rate risk through derivative contracts.

Both firms are helped by their ability to finance their acquisition of mortgages by issuing debt that financial markets believe to be backed by the federal government. As a result, they can raise money more cheaply than genuinely private financial institutions. The costs and benefits of this implied guarantee are much debated. Alan Greenspan, chairman of the Federal Reserve, believes that it distorts investment and removes the market's ability to control the mortgage companies. Peter Wallison of the American Enterprise Institute, a think-tank, believes that the companies' privileges could also skew mortgage costs in different regions across America.

The argument in favour of all this is that it lowers the cost of housing. By how much? When Fannie Mae was born 70 years ago in the midst of the Depression, the answer was: significantly. At that time, banks held on to mortgages, and the market was illiquid. Lending terms were restrictive, typically requiring full repayment within five years. This satisfied neither banks nor borrowers, actual or potential. Fannie Mae created liquidity, allowing banks to lend, sell the debt and lend again. The existence of Fannie Mae and Freddie Mac may be important explanations of why the mortgage market—unlike the stockmarket and markets for other debt—has never frozen up.

A study two years ago by the Congressional Budget Office (CBO), undertaken at Mr Baker's behest, estimated that the implicit federal guarantee was worth $10.6 billion a year. Of this, $3.9 billion went to the managers and shareholders of Fannie Mae and Freddie Mac. To most Americans, however, the main benefit comes in the form of lower borrowing costs. According to Mr Wallison, most studies show that the presence of Fannie Mae and Freddie Mac reduces interest rates on mortgages by about a quarter of a percentage point. However, at the lower end of the market the main impediment to buying a home is not the level of interest rates but the requirement to pay a deposit, typically 20% of the purchase price.

The mortgage markets may now be mature enough not to need Fannie Mae and Freddie Mac any more. Certainly, the two companies think that they have outgrown their original brief. Both have moved away from buying, packaging and selling mortgages towards retaining them instead. Because they can raise money cheaply, there is profit to be made from buying and holding higher-yielding mortgages. A consequence has been the swelling of their balance sheets (see chart). They have become such vast buyers that they have become a risk to liquidity. Suppose that, as some believe, America is going through a housing bubble. Given their exposure to mortgages, what happens if the bubble bursts?



Now America's accounting scandals have belatedly brought Fannie Mae and Freddie Mac into legislators' purview. Many on Wall Street have watched efforts such as Mr Baker's fail before, and are sceptical about the latest. Yet with every new, questionable report that emerges about the mortgage companies the pressure for change increases. Nobody in Washington wants to be tagged with having fiddled while Fannie and Freddie burned.

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South Korean banks

Shaving and investment

Jun 26th 2003 | SEOUL
From The Economist print edition

Another step towards the consolidation of South Korea's banking industry

AFP

IT WAS not a pretty sight. No fewer than 3,500 male employees of South Korea's Chohung Bank shaved their heads as part of a four-day strike to protest against the sale of their bank by its owner, the state, to Shinhan Financial Group. When they returned to work on June 24th, their bosses ordered 3,500 hats for them, lest their bald heads scare customers away.

Other problems will be harder to solve, although some things about the future of Chohung, which was resuscitated by the government in 1997 at a cost of 2.7 trillion won ($2.2 billion), are now clear. The bank, of which the state owns 80%, is due to be sold to Shinhan in early July, in a cash-and-shares deal valued at 3.4 trillion won. The merger will create South Korea's second-largest bank, with combined assets of about 150 trillion won (see chart). Curiously, a few years ago Chohung tried to buy Shinhan. But that was before the poor state of its loan book, the product of years of lending to support South Korea's industrialisation, became clear.

To persuade the strikers to return to work and accept the merger, the government and Shinhan are paying a high price. Certainly, the strike was damaging: angry customers transferred 6 trillion won to other banks when strikers threatened to shut down Chohung's central computer system. The strikers have been promised that Chohung will have “independent management” until the merger is complete in three years' time. The name Chohung will remain in use. There will be no lay-offs. Chohung employees' pay will rise to the levels of their counterparts at Shinhan.

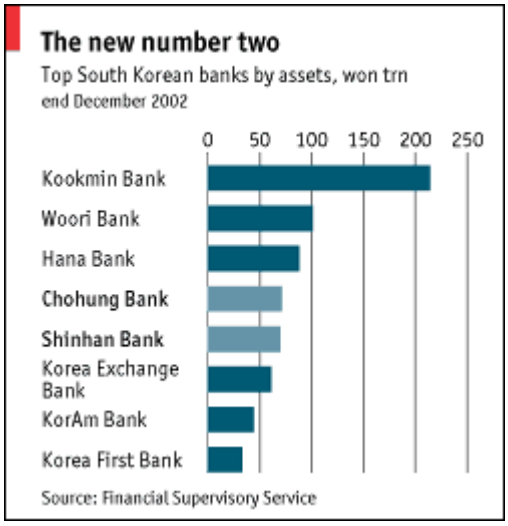
In making these concessions, the government has invited the fury of business organisations. It also seems to have given up many of the gains expected from the merger in the first place. Now that the closure of branches and shedding of jobs has been ruled out, says a foreign banker in Seoul, the likely benefits from fusing the two banks will be diluted. Nor is increasing pay at Chohung by 20-30% going to make the bank more profitable. The forgoing of savings matters all the more because Shinhan's and Chohung's businesses overlap a good deal. Both focus more on private lending than on corporate loans.

For all that, the deal should speed up two trends in South Korea's financial industry. One is consolidation. The deal follows Kookmin's purchase of Housing & Commercial Bank in 2001 and the merger last year of Hana Bank and state-owned Seoul Bank, which created the country's third-biggest lender. “Smaller banks like Koram and Korea First Bank will have to consider participating in consolidation to compete with the larger institutions,” says Koo Kyung-hwe of Meritz Securities in Seoul. Koram Bank may be the next to seek a merger, having previously counted on its own tie-up with Shinhan. Kookmin and Korea First are possible partners.

The second trend is towards the government's exit from the industry. Although the benefits from mergers have been elusive—Kookmin's profits in the first quarter were 598 billion won down on a year ago—the general opinion in South Korea is that the sooner the state sells its remaining stakes in several banks, the better.

The government's ownership of banks is even less popular abroad than at home. America's Department of Commerce recently imposed an import tariff of 44.71% on computer memory chips

made by South Korea's Hynix Semiconductors. It considers the 3.25 trillion won Hynix received from South Korean banks a form of illegal subsidy because the government owns shares in some of the lenders. The government says it had no hand in the financing. Even so, such wrangles are a further incentive to restructure South Korea's financial industry.



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Insurance in Poland

Home protection

Jun 26th 2003 | WARSAW
From The Economist print edition

Poland's leading insurer tries to shake off its past

ON THE face of things, Powszechny Zaklad Ubezpieczen (PZU) has reached its 200th birthday in fine fettle. The erstwhile monopolist still has the lion's share of Poland's burgeoning insurance market. It runs the country's third-largest pension fund. Under a new chief executive, in office just a month, it is preparing for the next stage of its privatisation. Yet PZU's celebrations will be muted. For nearly three years, it has been embroiled in one of central Europe's ugliest corporate-governance disputes.

The conflict pits Eureko, an Amsterdam-based alliance of European insurers, which in 1999 bought a minority stake in PZU, against Poland's treasury ministry, which still owns 55%. Eureko was also granted joint management control. The sale won the then government plaudits for trying to depoliticise the insurer, which had long been a murky source of patronage for post-communist governments. It seemed then that partial privatisation might curb the state's influence and improve the company's management. This has proved a vain hope.

The trouble began in November 2000, when a treasury minister asked a court to annul the sale to Eureko. He later forced Eureko's people off PZU's board. When Eureko complained to the European Commission that this was rum behaviour for an aspirant member of the European Union, the government made amends. In April 2001 it promised to sell Eureko a further 21% of PZU and to hold an initial public offering by the end of that year.

By then, however, a new, socialist government had taken over. It has refused to cede control, prompting an irate Eureko to launch arbitration proceedings before an international tribunal, as a Dutch-Polish investment treaty allows. Were the government to lose, it would be liable for damages. Perhaps more important, Poland's image as a host to investors would suffer.

Eureko and its partners may have been naive in their expectations of the benefits of a minority stake. Nonetheless, many of the state's appointees at PZU have been incompetent; some have been downright corrupt. Earlier this year the former head of PZU's life-insurance unit was charged with embezzlement and misuse of funds. In March, it emerged that the then chief executive had been plotting a management buy-out of minority shareholders, maybe including Eureko, without telling the treasury. A treasury minister quit when the prime minister refused to sack the boss.

The new chief executive, Cezary Stypulkowski, wants to end the dispute. A banker who took Bank Handlowy, one of Poland's biggest banks, public and then oversaw its sale to America's Citigroup, he is grooming PZU for a stockmarket listing next year. But he will not be Eureko's lackey. “The mood has changed,” he says, alluding to Poles' growing ambivalence about foreign capital.

This may not be what Eureko wants to hear, but Mr Stypulkowski has to tread carefully. His predecessors have not lasted long in the job, and the government remains capricious. Yet he runs a company with an enviable franchise, for all its troubles. Although it has lost clients to foreigners, it boasts over 50% of Poland's life and non-life insurance market. Its nationwide reach is impressive; in many small towns, it is the only insurer with an office. But PZU needs new IT systems and products, for which a successful public offering would be a boon. If its political bosses keep squabbling with Eureko, the foreign roadshows may have to be called off.

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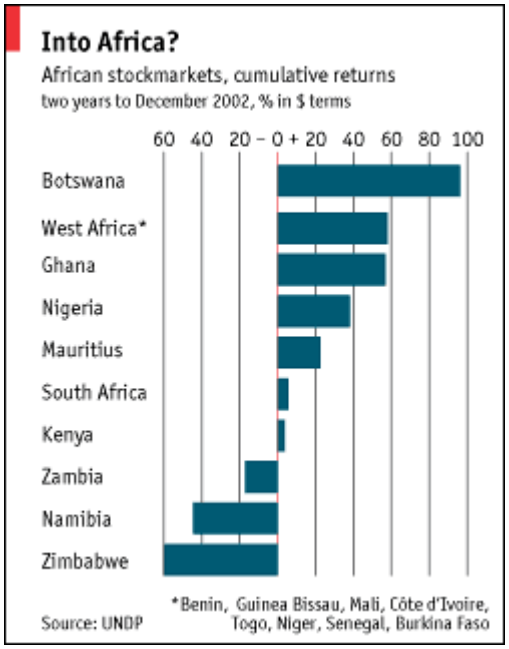
African stockmarkets

A capital idea

Jun 26th 2003 | JOHANNESBURG
From The Economist print edition

Thoughts of a pan-African exchange

WHICH stockmarkets have given investors the best returns in the past couple of years? Forget London, New York or even Moscow. Look instead at Accra, Gaborone and other African capitals. Ghana's all-share index rose by 45.6% last year in cedi terms. By June 23rd, it had climbed another 44%. In several African markets, returns have been juicy in dollar terms too (see chart). This year, even wretched Zimbabwe's stockmarket has just about kept pace with the country's rampant inflation rate.



Many of Africa's bourses are tiny, listing only a handful of companies and operating for just a few minutes a week. Despite their vulnerability to currency troubles, their recent success is attracting outside attention, especially from African-American investors. In the hope of keeping domestic capital in Africa and attracting more from elsewhere, new stockmarkets have been set up. Half of the continent's 21 exchanges have been opened in the past dozen years.

In unity, liquidity

Now plans are afoot to forge closer ties between them. They are driven by Johannesburg, the world's 16th-largest stockmarket, which has roughly three-quarters of Africa's total market capitalisation. The South African bourse has shared a trading system with neighbouring Namibia since 1997. Now Namibia, Zimbabwe, Zambia and Ghana are considering listing their companies on a separate African segment in Johannesburg.

“If talks next month go well, we can have a virtual regional exchange at one swoop,” says Russell Loubser, boss of the Johannesburg Securities Exchange. So far this year, ten exchanges have agreed to find ways of co-operating more closely with Johannesburg. A joint bourse already exists for eight mainly Francophone west African countries.

A regional exchange should mean more liquidity—the lifeblood of exchanges—by making stocks available to a wider range of investors. It might also prompt rating agencies to pay more attention to African companies. So why not go the whole hog and have a pan-African stock exchange? In all, says the United Nations Development Programme, 2,200 African companies are listed on the continent's various exchanges. Given the right technology and co-ordinated trading regulations, one bourse could do the whole job. Some companies, such as Anglo-American, a mining house, are already listed on more than one African exchange and would welcome more simplicity.

Mr Loubser and other enthusiasts see a pan-African exchange as a long-term goal. There are many obstacles, from differences in listing requirements to exchange controls, but Africa has every reason to move quickly, given its lack of capital. An extra incentive, perhaps, is the close link being forged between Johannesburg and the London Stock Exchange, whose electronic trading system the South African bourse already shares. Already, however, the LSE carries the primary listings of several big South African companies. So the rest of Africa beware: South African firms are looking at London every bit as keenly as at Windhoek or Nairobi.

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European clearing houses

Entente peu cordiale

Jun 26th 2003
From The Economist print edition

A cross-Channel merger that doesn't please everyone

THE London Stock Exchange (LSE), like an ageing spinster, makes a virtue of its enforced celibacy. Its list of estranged suitors or quarries over the years includes Crest, a British securities depository, Deutsche Börse, Germany's leading exchange, and LIFFE, a London derivatives exchange, which preferred marriage with Euronext, the joint bourse of Amsterdam, Brussels and Paris.

When the London Clearing House—which the LSE's members use to clear their trades—announced on June 25th that it had agreed a merger with Clearnet, a subsidiary of Euronext, the LSE immediately questioned the independence of the new entity. It said it was exploring "alternative clearing arrangements".

That rather dampened the announcement of LCH's and Clearnet's engagement, which came after two years of ruminations over how to satisfy national and European regulators and reconcile the mutual ownership of the LCH with Euronext's joint-stock arrangement. The agreed solution is a holding company, LCH.Clearnet Group, which will own two separate clearing operations, LCH in London, regulated by the Financial Services Authority, and Clearnet in Paris, overseen by the Banque de France and other French authorities. France's Commission Bancaire will also regulate the holding company which, to confuse things further, will nevertheless be London-based.

Euronext has agreed to limit its influence on LCH.Clearnet by capping its voting rights at 24.9% and reducing its 41.5% economic interest over time. Through LCH, 45.1% of LCH.Clearnet will be owned by its users, mostly big banks, subject to their agreement.

The LCH says that it had many talks and exchanged many letters with the LSE, discussing the governance and independence of the merged entity: so it was "disappointed" by the LSE's public outburst. The LSE, despite its own for-profit structure, argues that clearing and settlement should, in effect, be carried out by utilities that are owned by their users. It would like to see much stricter guidelines on how Euronext, a direct competitor of the LSE, would be constrained from using its influence on a pan-European "monopoly".

The LSE can imagine nothing better than the American arrangement, in which the mutually owned Depository Trust & Clearing Corporation acts as the dominant clearing-house for American securities trading. It admits that the LCH has taken steps, in the draft agreement, to "try to neutralise" Euronext's influence. "But it is a compromise of the LCH's existing status," says Phil Bruce of the LSE. Accordingly, the LSE will review its clearing agreement with the LCH.

The LCH and Clearnet have a different vision, which involves giving users a choice of clearing counterparty after they have traded on one of many European exchanges. With transparent pricing, that should reduce clearing costs and allow more efficient use of collateral. But it may take a few years before the vision becomes reality.

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Economics focus

Taxes and taxis

Jun 26th 2003
From The Economist print edition

Can tax cuts save the global economy? Ask a cab driver

IT IS a fair bet that, on any given day, some politician somewhere is proposing a change in income-tax rates. In America, administration lobbying plus economic nerves have pushed Congress into voting for a tax-cut package: refund cheques will be in the post this summer. In Germany, where the economy has been shrinking, there is talk of bringing forward to 2004 tax cuts planned for 2005. In Britain, a cabinet minister has been scolded for suggesting that high earners might be happy to pay more tax so that those lower down the scale could pay less.

As a vote-winning measure, tax cuts have obvious appeal: people usually prefer to spend their money themselves, rather than let the government do it. But to economists, the question is a bit more complicated. Given that governments must raise money through taxation, how can they do so at least cost to the economy? By and large, economists prefer taxes that change the relative prices of goods and services as little as possible, and so cause the minimum distortion to people's spending and investment decisions.

The least distorting of all may be lump-sum taxes—poll taxes, if you prefer. But these tend to hurt the poor disproportionately. Partly for that reason, they are also unpopular, as Margaret Thatcher found when she introduced just such a tax in Britain. So some distortion may be inevitable. Income taxes can cause an especially serious distortion, because they affect the choice between leisure and work (and thus, in effect, between leisure and all the things that wages can buy). Low marginal income-tax rates are therefore a special favourite among economists.

Yet the precise relationship between income-tax rates, economic growth and tax revenues depends on how changes in tax rates affect people's behaviour. On the one hand, lower marginal tax rates give people an incentive to work more, because they can keep a larger share of every dollar they earn. This “substitution” effect means that people may work harder—so much harder, indeed, that they might end up paying more tax. This was the answer, once offered by Arthur Laffer, that was most easily understood by Ronald Reagan. He was fond of recounting how, as a Hollywood actor, he would receive pennies in the dollar for each extra film he made, thanks to the high marginal tax rates of the 1940s. During Mr Reagan's presidency, America's top federal tax rate fell from 70% in 1980 to 28% in 1988. Under Bill Clinton, it went up again, to around 40%. George Bush has cut it this year to 35%.

On the other hand, a cut in the marginal income-tax rate usually means a lower average tax rate too. So people will not have to work so hard to reach the same level of income after a tax cut as they did before. If this “income” effect outweighs the substitution effect, people will work less hard and pay less tax. They may be happier, but the treasury will be emptier.

Flexitime for Bonzo

Some evidence is supportive of Mr Reagan's instinct that people tend to work harder when tax rates fall. One exhaustive study, by James Ziliak and Thomas Kniesner*, makes use of sophisticated econometric techniques to show that labour supply of American men rose by around 3% after the tax cuts of the 1980s. However, there is little evidence for the Lafferite belief that lower tax rates would encourage people to work so much harder, or draw so many new people into the workforce, that the government ended up with higher revenues. Economists also agree that the labour supply of families' secondary earners—usually women—is more responsive to tax changes than that of the main breadwinners, especially if (as in some countries) income tax is applied to the whole family, not to its individual

members.

That said, the evidence is not clear-cut. One reason is that most people have less flexible jobs than Mr Reagan did in his acting days. There is some evidence that America's tax cuts in 1986 did not cause high-wage men to work any harder, perhaps because such people were already clocking up around 3,000 hours a year at the office. Most workers on more modest pay put in a set 35 or 40 hours a week, regardless of the marginal rate of income tax. Higher taxes may dissuade them from seeking a more demanding job at higher wages, but this effect is hard to measure.

Given the cloudiness of the macroeconomic evidence, some economists have looked at the behaviour of individual groups of workers, especially those able to choose how long they work. A few years ago, one study† looked at how New York taxi drivers responded to increased wages—which ought to have the same effect as a tax cut. Cabbies, reckoned the economists, have a "target income". Once they earn, say, $200, they go home, even if it is a busy Saturday night and there is easy money to be made.

If target incomes were common, tax cuts would bring about less effort rather than more, especially because flexible work has become more important in most rich countries. However, a new paper‡ by Henry Farber, of Princeton University, suggests that cabbies respond positively to the prospect of higher pay. Mr Farber—who not only analysed taxi drivers' trip sheets but also, unusually for an economist, spoke to his subjects—argues that cabbies put in more hours when the pickings are rich, say during a convention or a theatre season, and take more leisure when business is slow. Studies of bicycle messengers and stadium food-vendors have reached a similar conclusion. It seems that higher returns encourage more effort, not more leisure, when people have some control over their work hours.

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* "Estimating Life Cycle Labor Supply Tax Effects". *Journal of Political Economy*, 1999

† "Labor Supply of New York City Cab Drivers: One Day at a Time", by Colin Camerer, Linda Babcock, George Loewenstein and Richard Thaler. *Quarterly Journal of Economics*, 1997

‡ "Is Tomorrow Another Day? The Labor Supply of New York Cab Drivers". NBER Working Paper 9706, May 2003

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About sponsorship

Correction: Lehman brothers

Jun 26th 2003
From The Economist print edition

In last week's article on investment banking ("A spring in their step"), we did Lehman Brothers a disservice. A chart should have shown its share price to be the best-performing this year of the four shown, not the worst. Sorry.

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Energy

There's oil in them thar sands!

Jun 26th 2003 | FORT MCMURRAY, ALBERTA
From The Economist print edition

Could Canada's vast tar sands prove the ultimate anti-OPEC resource?

EVERYONE knows that Saudi Arabia is the undisputed king of the castle of oil. After all, the official statistics have long made it clear that the country sits on top of a quarter of the world's proven reserves of petroleum. Moreover, four of its neighbours—including Iraq—can claim about a tenth apiece. In contrast, the United States (which consumes a quarter of world oil production) controls a mere 3% of the world's reserves.

So the Middle East remains the only place that really matters in the oil world, right? Wrong, according to the Canadians. For decades, they have been complaining that the official bean-counters have unfairly neglected the energy trapped in the Athabasca tar sands of Alberta—rock formations laced with hydrocarbons that can be mined and processed to yield barrels of oil. Geologists have long claimed that the energy content of these sands is so great that there may be more oil trapped in Alberta than under all of Saudi Arabia. The snag, of course, is that it takes far more energy and money to squeeze oil out of this mucky stuff than it does to pump it out of the ground at a conventional oilfield.

Undaunted, energy companies have ploughed billions of dollars into bringing down the cost of producing oil from tar sands. This has dropped from about $30 a barrel three decades ago to less than $12 a barrel at the latest facility, which was officially opened by Royal Dutch/Shell and its partners on June 19th, and joins plants run by Suncor and Syncrude, two Canadian firms whose businesses are built around the tar sands. An article in *Oil & Gas Journal* declared recently that some 180 billion barrels of oil trapped in those tar sands should now be considered economically viable, and so classified as “conventional” oil. That notion, were it recognised, would knock Iraq (with reserves of 113 billion barrels) into third place. And last month America's Energy Information Administration did indeed recognise it.

This news set off a wave of euphoria in Canada. Ralph Klein, Alberta's premier, and Murray Smith, its energy minister, trumpeted the potential of the tar sands to investors during a visit to New York this week, while Neil McCrank, the province's top energy regulator, insisted that Alberta's oil production could one day rival that of Saudi Arabia itself.

Squeezing oil from a stone

For politicians, this is heady stuff. But Canada is still some way from becoming an oil superpower. If the country's tar sands are ever to yield their bounty to the world's consumers, producers must overcome technical obstacles in three areas: complexity, cleanliness and cost.

First, consider how hard it is to squeeze oil from rock. Only 8-16% of the material takes the form of bitumen, the desirable, energy-rich bit. The rest is clay, sand and other unwanted stuff. Also, a lot of the bitumen lies too far underground to be mined, and has therefore to be pushed to the surface by injecting steam into the ground through many costly wells.

Engineers and miners have come up with two techniques that have greatly reduced costs here. For projects aimed at tapping the deeper reserves, they are able to use the fancy multi-directional wells now commonly employed in deep-sea oil drilling. Two of these (one for injecting the steam, one for extracting the bitumen) will do a job that once required many individual, vertical wells. Innovative technology is helping with surface-mining operations, too. At Shell's vast new strip-mining project, monstrous lorries (the world's largest, with each four-metre-tall tyre alone costing some $40,000) zoom back and forth from the open pits. They dump their 400-tonne payloads into a mixer, which heats the gunk as it revolves. The result is that the bitumen separates from the sand, which sinks to the bottom. “We just add hot water and stir!” joke company officials.

Such advances are useful, but they do not bring Alberta within spitting distance of the Middle East. Saudi Arabia's oil is so easily reached that it takes little more than a pipe stuck in the ground to set it gushing out. To get Shell's tar-sand project off the ground, by contrast, required well over 10,000 employees and a huge industrial operation—not an easy task, considering that the sands are located in a region where winter temperatures of –30°C are common. Shell's project is already an incredibly complex operation at its current output of below 200,000 barrels a day. But that is a drop in a bucket compared with Saudi Arabia's daily production of about 8m barrels.

Another technical snag looks likely to be the environmental impact of producing oil from tar sands. For a start, the process uses enormous amounts of water. The Shell folk insist that they recycle much of it, but even they accept that water scarcity will become an issue if many tar-sands operations take off in future. Indeed, local people are grumbling already.

Another technical snag looks likely to be the environmental impact

How green was my sandpit

A bigger environmental headache is the Kyoto protocol, a treaty on climate change that Canada's government has just signed. This imposes constraints on how much climate-changing “greenhouse gas”—in particular, carbon dioxide—a signatory can emit. Since Alberta is a huge emitter of greenhouse gases, and the production of oil from tar sands is particularly carbon-intensive, it will make meeting the treaty's targets a lot harder.

The industry has, however, come up with ways to reduce the “carbon profile” of tar-sands production. Some try to clean up the actual operation. Others involve so-called offsets, such as planting forests elsewhere to absorb equivalent amounts of carbon dioxide from the atmosphere, or the purchase of credits from those who have beaten government-imposed pollution targets, and are thus allowed to sell the balance of their quotas.

By 2010, vows Shell, its tar-sand project will emit only as much greenhouse gas per barrel as a “weighted” barrel of the various grades of crude oil imported into North America. Indeed, the firm has produced fancy charts suggesting that the production and consumption of oil from tar sands emits only about 5% more greenhouse gas per unit of fuel produced than does the weighted mix of imported oil.

At first sight, this looks impressive. But a closer examination suggests that, because Shell includes in the weighted mix a lot of heavy oil from Venezuela (carbon-intensive stuff that greens also object to), the comparison flatters fuel made from tar sands. Also, because greenhouse gases emitted when people consume oil by burning petrol in their cars far outweigh those resulting from the manufacturing process of producing the fuel, the firm's analysis underplays the difference between emissions from the actual production processes.

Look strictly at greenhouse-gas emissions resulting from the production and transport (but not consumption) of oil from the two putative titans of the oil world—Saudi Arabia and Alberta—and you get a different picture. Shell's own figures reveal that, barrel for barrel delivered to the American mid-west, tar sands emit about 25% more greenhouse gases than Saudi oil. That sort of gap will be hard to close without huge and costly investments in carbon-abatement technologies, or offsets and credits, or both. And that points to the third, and most important, reason to take all the recent hoopla over tar sands with a grain of salt: economics.

It is true that the companies involved have made dramatic strides in reducing costs, but even $12 a barrel is too high for Alberta to be anything other than a marginal producer. One problem is that labour is extremely expensive in this Arctic wilderness. A bigger one is the assumption made by advocates of tar

The Saudis, with their vast reserves and low

sands that oil prices will remain relatively stable.

costs, will remain the “swing” producers of the world's oil market

What wishful thinkers in Canada forget is that the Saudis, with their vast reserves and low costs, will remain the “swing” producers of the world's oil market. That allows them to manipulate prices, and to retain their grip on the fractious OPEC cartel. History shows that Saudi Arabia talks a lot about price stability, but in practice engineers (or bungles its way into) occasional price collapses that splash cold water on potential investments in marginal projects such as those in Alberta. Indeed, when the world oil price collapsed to $10 a barrel nearly five years ago, several seemingly eager investors suddenly lost interest in what looked to be promising tar-sands ventures.

In all probability, therefore, Alberta will never be a true rival to Saudi Arabia. Despite the technology, economics will ensure that most of the oil trapped in the tar sands never sees the light of day. Even so, the tar sands do provide consumers with a useful check on OPEC. Should Saudi Arabia ever get too greedy, and keep prices in the stratosphere for any length of time, marginal producers such as those in Alberta will come to the rescue. And, of course, developments in the far north of Canada should also put to rest the absurd but still oft-voiced claim that the world is about to run out of oil.

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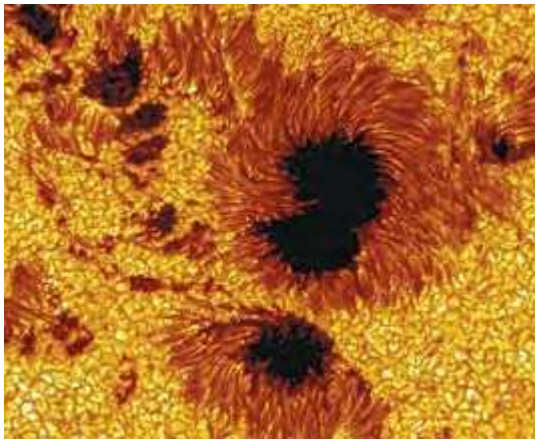
Sunspots

Staring at the sun

Jun 26th 2003
From The Economist print edition

An explanation for the sunspot cycle



IN 1843 Heinrich Schwabe, a German astronomer, realised that sunspots, the black blotches that disfigure the solar surface, come and go in cycles of around 11 years. Subsequent work has shown that other solar activities, such as flares and coronal mass ejections, follow the same cycles. Since such “solar weather” affects the weather on Earth, and also plays havoc with satellite-based communications, the cause of these cycles is of more than just academic interest.

That cause, however, has proved elusive. One hypothesis invokes a “deep meridional flow” in the sun—a current of gas supposed to travel from the poles to the equator at a depth of about 100,000km. This would drag the spots around with it. Its principal competitor theory involves something called a “simple dynamo wave” on which the spots would surf.

David Hathaway and his colleagues at NASA's Marshall Space Flight Centre, in Alabama, believe they have resolved the argument. As they told a recent gathering of the Solar Physics Division of the American Astronomical Society, in Laurel, Maryland, it's the flow wot does it.

Sunspots form near the poles as a result of magnetic anomalies. Once formed, they drift towards the equator. The question is why. Using observations from Britain's Royal Greenwich Observatory, which go back to 1874, along with more recent pictures taken by the American air force, Dr Hathaway was able to count the number of sunspots at various solar latitudes over the years, and thus to measure the drift in detail. Unexpectedly, he found that the maximum drift speed of the sunspots in a given cycle predicts the intensity not of the next cycle, but rather of the next but one.

This implies that the sunspot cycle has a “long memory”, which is compatible with the meridional-flow hypothesis, but not the dynamo-wave hypothesis. And the details of Dr Hathaway's trawl through the archives match computer models of the meridional flow precisely. Although similar observations have been made before, Dr Hathaway's are the first, he claims, to provide an unambiguous explanation of what governs the sunspot cycle.

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Spider mating

Sex and suicide

Jun 26th 2003
From The Economist print edition

Why self-sacrifice makes perfect sense for spiders

AS GENERATIONS of biology students have discovered to their morbid delight, the mating behaviour of creepy-crawlies can be bizarre. The classic example is lovemaking among praying mantises, where the female has sex with her partner, then eats him for dessert.

But the mantis has nothing on its distant cousin, the orb-weaving spider. These spiders, too, have turned copulation into a girl-eats-boy story. In this case, though, the male seems to offer himself as a sacrifice, to the point of actually killing himself before the female has a chance to.

When desire eventually gets the better of a male spider, he performs a series of complicated acrobatics, inserting a sperm-carrying organ known as a pedipalp into his mate and then returning after that bout of copulation to insert his other pedipalp into her. After this, most male spiders try to make a speedy getaway. In the case of the orb-weaver, however, the male actively terminates himself within minutes of inserting his second palp. His heartbeat ceases and he curls up and dies—even before the female can begin attacking him.

On the face of it, this seems insane. Since most orb-weaving spiders do it, however, there has to be an explanation. Somehow, the male's odd behaviour must offer an evolutionary advantage.

Theories abound that male self-sacrifice may be a logical extension of the practice employed by many animals, including insects and spiders, of the male bringing a gift of food to encourage the female to mate. Such food, whether it be a neatly wrapped fly, or the body of the dead male, provides nutrients for the female, allowing her to produce bigger or more numerous offspring, to the ultimate benefit of the father's genes. This, however, is unlikely to account for the death of male orb-weaving spiders. They are much smaller than their mates, and thus of rather limited nutritional value.

Matthias Foellmer of Concordia University in Montreal and Daphne Fairbairn of the University of California, Riverside, believe they have found at least part of the answer. As they explain in a paper in the *Proceedings of the Royal Society*, other males may fight over access to the female and try to dislodge any male that has an inserted palp. However, the palps of dead males are fixed in an inflated state, making them hard to remove. As a result, dead males may act as plugs to prevent other males from copulating, ensuring that the suicidal male, not a rival, fathers the offspring. In short, who dares win will die—but his genes are more likely to live on in the next generation.

Dr Foellmer and Dr Fairbairn cite a peculiar instance of a male spider that died after mistakenly inserting his second pedipalp into the carcass of a mealworm. This suggests that insertion of the second palp was enough to trigger death, even in the absence of a genuine female orb-weaver. So one shot, it appears, is all that a male orb-weaving spider gets. But by sacrificing himself to ward off other amorous males (even when his mate is nothing but a dead mealworm), he certainly makes sure that it is his best shot.

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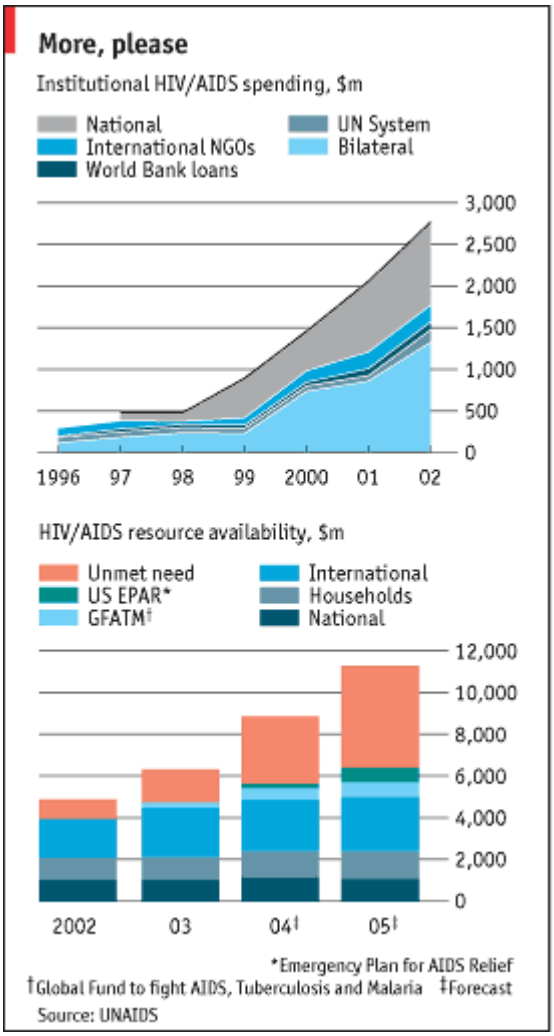
AIDS

Money, money, money

Jun 26th 2003
From The Economist print edition

Spending on AIDS is rising, but perhaps not by enough

AS THE lobbying season for AIDS-aid gets going in earnest, UNAIDS, the United Nations agency charged with combating the disease, has released its latest figures on how much money has been raised in the past, and how much it thinks will be needed in the future. The first two charts in its report seem designed to create just the right atmosphere of hope and concern. One shows that AIDS spending in poor countries has risen tenfold over the past seven years, and that poor countries are taking their responsibilities seriously by providing over a third of the total (up from close to zero). The other suggests that the ratio of unmet need to actual spending is rising. Cue the rattling of collecting tins.



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About sponsorship

The Carlyle Group

C for capitalism

Jun 26th 2003
From The Economist print edition

The secretive Carlyle Group gives capitalism a bad name. But dismantling the whole system (see article) may be slightly over the top

ON the day Osama bin Laden's men attacked America, Shafiq bin Laden, described as an estranged brother of the terrorist, was at an investment conference in Washington, DC, along with two people who are close to President George Bush: his father, the first President Bush, and James Baker, the former secretary of state who masterminded the legal campaign that secured Dubya's move to the White House. The conference was hosted by the Carlyle Group, a private equity firm that manages billions of dollars, including, at the time, some bin Laden family wealth. It also employs Messrs Bush and Baker.

In the immediate aftermath of the attacks, when no one was being allowed in or out of the United States, many members of the bin Laden family in America were spirited home to Saudi Arabia. The revival of defence spending that followed greatly increased the value of the Carlyle Group's investments in defence companies.

The Carlyle Group is a godsend for conspiracy theorists who are convinced that the world is run by, and on behalf of, a shadowy network of wealthy men. Sure enough, it was not long before Cynthia McKinney, a Democrat member of Congress, pointed a finger at Carlyle, noting in an interview that “persons close to this administration are poised to make huge profits off America's new war” and that, despite “numerous warnings”, they did not alert the “people of New York who were needlessly murdered”. “What”, she asked, “do they have to hide?”

You need not be a conspiracy theorist, though, to be concerned about what lies behind Carlyle's success. Can a firm that is so deeply embedded in the iron triangle where industry, government and the military converge be good for democracy? Carlyle arguably takes to a new level the military-industrial complex that President Eisenhower feared might “endanger our liberties or democratic process”. What red-blooded capitalist can truly admire a firm built, to a significant degree, on cronyism; surely, this sort of access capitalism is for ghastly places like Russia, China or Africa, not the land of the free market?

The Iron Triangle: Inside the Secret World of the Carlyle Group
By Dan Briody

Wiley; 240 pages; $24.95 and £17.50

Buy it at
Amazon.com
Amazon.co.uk

Named after the luxurious New York hotel favoured by the firm's founders, Carlyle even got started by exploiting a tax loophole, a legitimate capitalistic activity, if not an honourable one. This particular loophole bizarrely allowed profitable American firms to enjoy a large tax break by buying the losses incurred by Eskimo-owned companies in Alaska. In 1987, this opportunity brought together a flamboyant dealmaker, Stephen Norris, who left Carlyle in 1995, with David Rubenstein, a former aide to President Carter and still the brains behind the firm.

After this initial success, though, the going got tougher. Carlyle missed out on several attractive deals while completing some duff ones, including buying a stake in Caterair International, a company that later collapsed under the weight of its junk-bond financing. Still, it did introduce them to a man who became well worth knowing: George W. Bush, a director of Caterair.

Carlyle really only took off after it hired Frank Carlucci, a former secretary of defence and deputy director of the CIA, in 1989. Mr Carlucci was able to open doors in Washington that had hitherto been closed to the firm, allowing it to participate in many lucrative deals.

Although Dan Briody's book is useful reading for anybody interested in American politics today, it tells Carlyle's story in the style of a Tom Clancy or John Grisham novel. This is rather a shame. Instead of expanding in an unrelenting tone of shocked disapproval, the author could have offered a serious view on a number of difficult questions.

For instance, if privatisation can increase the efficiency of the notoriously inefficient defence sector, how should the inherent political and security risks best be managed? Given that the rewards for success in the private sector so far exceed those for public service, how can talented people be persuaded to enter public service without their former private-sector activities becoming a source of suspicion?

While some former presidents are happy to play golf, others may feel they can still earn a decent living. What rules should govern the commercial activities of former President Bush; or, for that matter, former British prime minister, John Major; or former South Korean prime minister, Park Tae-joon—all of whom have taken the Carlyle nickel? Mr Bush senior receives private intelligence briefings that are not available to ordinary investors. Does his inside knowledge of, and possible influence over, the administration's political strategy towards, say, North Korea and Saudi Arabia directly benefit Carlyle? If so, does that constitute an unacceptable conflict of interest?

Perhaps there would be less reason to worry about Carlyle if there were rival clubs of ex-political heavyweights competing within the iron triangle. Alas, this firm seems to be an aspiring monopolist, hoovering up former public officials from across the political divide and, increasingly, from across the world. It is becoming more ambitious in Europe, and keenly eyeing China. Perhaps there would be less reason to worry if Carlyle's activities were more open—but as a private equity firm, it has largely escaped America's recent efforts to improve the governance and transparency of companies, which is unfortunate. At a time when America is aggressively promoting democracy and capitalism abroad, including by military means, it would be helpful if its politicians and businesses were regarded as cleaner than clean. Shrouded in secrecy, Carlyle calls capitalism into question.

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By Dan Briody.
Wiley; 240 pages; $24.95 and £17.50

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About sponsorship

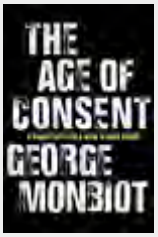
Global capitalism

Mutatis mutandis

Jun 26th 2003
From The Economist print edition

TIP O'NEILL, the late great Democratic speaker of America's House of Representatives, famously said that “all politics is local”. Not in the mind of George Monbiot, a British journalist and campaigner for something he calls global justice. Mr Monbiot thinks all real politics is global, for it is at a global level that the rich (principally America) impose the rules that keep the rest of the world in grinding poverty, using the evil IMF to impose huge debts on them and exploiting unfair trade rules to plunder their economies, in a “global dictatorship of vested interests”. All is not lost, however, for the dictatorship has created the seeds of its own destruction. It has laid the way towards what Mr Monbiot hopes will be a global revolution, to bring about a global parliament, which would use the voting power of the poor masses to overturn the hegemony of the rich.

The Age of Consent
By George Monbiot



Flamingo; 274 pages; £15.99. To be published in America by the New Press in the autumn

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That is a toned-down summary of his ingenious plan. He lays it out in a series of what he calls “repulsive proposals”, a term he naturally uses to mean the opposite: he thinks his ideas are so attractively radical that they will be adopted by the world's people in something he calls a “metaphysical mutation”. It is a sort of philosophical revelation, a change of consciousness that, once begun, takes on an irresistible logic all of its own. Central to it is the idea that poor people everywhere share interests that span borders and cultures. So if you had a world parliament in which everyone's vote counted equally they would vote not for narrow nationalisms, as Chinese or Americans, but for what really matters in shaking off the yoke of debt, saving the environment and “curtailing the world-eating and mathematically impossible system we call capitalism”.

Aware of the mathematically possible, you may by now be wondering how it is that a billion Chinese, say, will be able to take part in this given that at a local level they live in a dictatorship. Mr Monbiot has an answer: voting powers, whether in the parliament or in his proposed democratic replacement for the United Nations Security Council, will be weighted according to whether countries are democracies at home. Thus China will have a powerful incentive to democratise, so as to be able to carry its full weight in world affairs.

Aware of the politically possible, you may be wondering how this is to be brought about. Mr Monbiot describes today's world (and that of the past 500 years) as an Age of Coercion, to be replaced by an Age of Consent. But, of course, to bring about such change would require coercion, to overthrow the current system, which includes the Chinese communist dictatorship along with others. Not, you understand, the sort of coercion used by George Bush in overturning Saddam Hussein's dictatorship, for that was outrageously in violation of international law and public opinion.

So in Mr Monbiot's world, mass-murdering dictatorships would be protected when public opinion would rather they be left alone? Well, yes. But in Mr Monbiot's world, poverty would be eliminated by a new “international clearing union” under which countries running trade surpluses (watch out, China) would be fined and the money handed to poor ones running trade deficits; farm and textile trade would be free yet all other trade would be highly regulated, with infant-industry protection encouraged for the poor. In such a world there wouldn't need to be third-world dictators such as Mr Hussein, so presumably they would disappear.

The difficulty in arguing with this view lies in working out where to start. With the fact that, in this age of coercion, the proportion of the world's population living in democracies has actually risen? Or that at this time when the rich grind their

Reuters

heels in the faces of the poor there has actually been a dramatic fall in world poverty, with the proportion of the world's population living on less than $2 a day halving in the past 20 years? And that this has been achieved because more and more countries have adopted a more market-oriented system for the impossible world-eater, capitalism? Or that even if there was a world parliament it would be beset by the same worries about national sovereignty and interests that lead British public opinion to be so sceptical of the European Union?

In the end, though, the argument is impossible. Mr Monbiot works in a different language, with a different set of “facts” and altogether on a different metaphysical plane from the rest of us. For he has gone through the mutation.

Watch me bring it all down

The Age of Consent.
By George Monbiot.
Flamingo; 274 pages; £15.99. To be published in America by the New Press in the autumn

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About sponsorship

The Clinton presidency

Big Bad Bill or Sweet William

Jun 26th 2003
From The Economist print edition

It's not his enemies that Bill Clinton has to watch out for, it's his friends

WILL Bill Clinton ever get a fair press? Say what you like about the honey-tongued rogue, but the most gifted politician of his generation kept the peace, balanced the budget and presided over prosperity. Since then, these achievements have been mauled by conservative revisionists. Mr Clinton was soft on terrorism, they shriek; he let an economic bubble inflate; he devalued the presidency.

Now what Hillary Clinton once labelled "the vast right-wing conspiracy" has unveiled its most lethal weapon: Sidney Blumenthal. Forget the Fox News Network, let Rush be hushed, one and all the editors of the *Wall Street Journal* can lay down their pens: all their outpourings on Monica and Marc Rich will never turn you against Mr Clinton as rapidly as "The Clinton Wars".

Alas, that was not the author's intention. Mr Blumenthal aspires to be Mr Clinton's definitive defender, and he could have been. The author of several decent books, he was one of Mr Clinton's special advisers and saw the presidency at close hand. And he has a mountain of information about the lengths that conservatives went to in order to smear all the Clintons, including Chelsea.

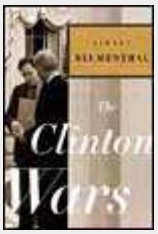
From even a semi-objective writer, "The Clinton Wars" could have been a cracking good read. The argument that, yes, Mr Clinton sinned but he was far more sinned against is worth considering. Mr Blumenthal, however, cannot admit the bit about Mr Clinton sinning—even though his hero was caught telling the most televised whopper of all time. Instead, the same Clintophilia that once persuaded the *New Yorker* to remove Mr Blumenthal as its Washington editor reaches proportions as grotesque as the Clintophobia of the opposition.

Just as the word "liberal" is spat out by the Clinton-haters to mean "traitor", "conservative" here is shorthand for "bastard". When, for instance, a character appears as "Indiana's own Mr Conservative", you know he eats babies. In a wonderful section on Newt Gingrich, Mr Blumenthal carps about the Republican speaker having too much facial hair as a student, experimenting with drugs, and having sex "on his brain a lot". It never crosses the author's mind that these things might also have applied to Saint Bill; but it certainly occurs to the reader, and once the suspicion that you are being treated like a patsy sets in, you find yourself searching for faults in Mr Clinton more avidly than Kenneth Starr.

In the end, the book becomes a weird 800-page insult not just to the reader's intelligence but to Mr Clinton's. The cleverest president of recent times can only be embarrassed by such artless propaganda. Already the book seems to have become something of a joke even in the sort of liberal institutions where Mr Clinton would want his legacy to be treasured. The *New York Times* this week has a cartoon showing a certain "Sy Swoonenthrald" holding up "The Clinton Wonderfulness", assuring his readers that "I never actually saw him walk on the water, but I know in my heart that if a situation called for it..."

In contrast, Mr Clinton must feel relieved with his wife's effort. True, "Living History" is also propaganda, but, coming from a politician, it grates less. The book's main aim is a complicated piece of politicking: establishing that the Clinton marriage was for real (crucial for winning over the more traditionally minded

The Clinton Wars
By Sidney Blumenthal



Farrar, Straus & Giroux; 822 pages; $30. Viking; £25

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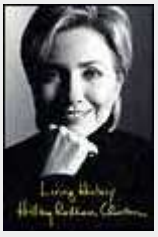
Amazon.co.uk

Living History
By Hillary Rodham Clinton



Simon & Schuster; 562 pages; $28. Headline; £20

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soccer moms), while putting a little ground between Mrs Clinton and her husband.

Mrs Clinton's book has provoked predictable howls of derision from the Clintophobes, not least for the notion that she, like Captain Renault discovering gambling in Casablanca, could be so shocked to stumble across adultery in her marriage. But these howls mainly reflect frustration. If book sales are anything to go by, the Democratic candidate in 2008 has pitched just the right amount of revelation, deprecation (she mocks her hair and seriousness) and personal arcana (she loved Barry Goldwater as a girl). When asked about her marriage in five years' time, she can say “I covered that in my book [which by then she might well call ‘Ancient History']. Let's talk about the real issues.”

In this cleansing process, Mr Clinton does take a bit of a scrubbing over Monica and his “punctuality-impaired” nature. His wife even shifts a little of the blame for her failed health-care plan on to him. But you are often reminded of his gifts. On their first date, the bearded Arkansan took the cleverest woman in his class to a Mark Rothko exhibition at the Yale Art Gallery, only to find it closed because of a union dispute. Yet the southern hippy charmed the Yankee staff to let them in, and the couple had the whole museum to themselves. That boy, it must have seemed, could talk his way into the White House.

The Clinton Wars.
By Sidney Blumenthal
Farrar, Straus & Giroux; 822 pages; $30.
Viking; £25

Living History.
By Hillary Rodham Clinton.
Simon & Schuster; 562 pages; $28.
Headline; £20

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About sponsorship

Literary biography

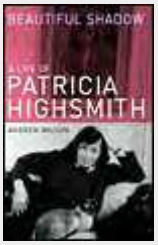
Murder for pleasure

Jun 26th 2003
From The Economist print edition

MURDER, Patricia Highsmith observed, “is a kind of making love, a kind of possessing”. She described feeling “quite close to murder”, with her hands on her lover's throat instantly making the victim “cool and rigid as a statue”. Highsmith did not make this extraordinary confession in public. She carefully guarded her private thoughts. Luckless reporters who were sent to interview her and sought some revealing quote would be told, “The question is dismissed” or simply “No”. To fill their space they might be reduced to writing about what she was wearing (usually jeans with a man's shirt and tie), and hinting at her lesbianism.

Highsmith's only confidant was her notebook. Many writers keep notebooks. Most of these are dull. The others do not always survive. Byron's memoirs were burnt. Highsmith thought about destroying her notebooks. For those who admire her novels and want to know more about her, it is a gain that in the end she could not bear to toss them on the fire, and none of her numerous lovers seems to have had access to them. It is a particular gain that after her death in 1995 they were entrusted to Andrew Wilson, who has used this material, together with much else, to write a biography, “Beautiful Shadow”, that is exemplary in its exploration of a writer's mind.

Beautiful Shadow: A Life of Patricia Higsmith
By Andrew Wilson



Bloomsbury; 544 pages; $32.50 and £25

Buy it at
Amazon.com
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In bookshops Highsmith's novels are usually displayed with detective stories. But detective stories, she said, are simple puzzles. Spot the villain among the half a dozen suspects. She was not interested in that sort of puzzle. In a Highsmith novel the villain will be known to the reader, who will accompany him on his often dreadful crimes, and be made an accomplice in evil. We are into Dostoevsky territory here, probing into the criminal and abnormal mind.

Highsmith said that the prime purpose of her work was to entertain. But it is entertainment of a disturbing sort that is a snub to conventional conduct. She fully exercised the writer's near-criminal licence to eavesdrop, read minds, to be a voyeur, to have the power of the judge, the police and the executioner. An imaginative writer, she observed, “has to forget about personal morals” and “to feel anything is possible”. Her best known character, Tom Ripley (played here by Matt Damon), is a charming psychopath who appears in five of her 22 novels, and several films. “The thud of a corpse falling into a freshly dug grave gives him a positively delicious pleasure,” Mr Wilson notes, but he also has a taste for fine art and fine music. The criminal, Highsmith said, was the perfect example of the modern hero, “active, free in spirit”.

One question that inevitably arises is how much Patricia Highsmith, a woman of the utmost public respectability, who never even diddled the taxman of a penny, lived another awful life deep in the dungeons of her mind. Mr Wilson has spent a lot of time with her in those dungeons, perhaps in the process feeling a bit odd himself; at one stage he took to wearing her dressing gown and thought he caught a glimpse of her, “a shape which was unmistakable”. All in the cause of truth, no doubt. If you want to know what goes on in the thoughts of a writer of fiction, this is a book to read. But a health warning: it is not very nice.

Beautiful Shadow: A Life of Patricia Higsmith.
By Andrew Wilson.
Bloomsbury; 544 pages; $32.50 and £25

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About sponsorship

Contemporary photography

Pictures at an exhibition

Jun 26th 2003 | AMSTERDAM
From The Economist print edition

Rineke Dijkstra's portraits are as intimate as they are revealing

Venus rising

RINEKE DIJKSTRA likes to photograph people on the cusp of change, at landmarks in their life or at moments when they are not quite composed: children on the edge of adolescence, for example, or Israeli teenagers on the day they are drafted into the army. “People think that they present themselves in one way, but they cannot help but show something else as well,” says the 44-year-old Dutch photographer, whose pictures combine conceptual rigour with formal classicism, and whose work is fast becoming nearly as sought after as that of other photographers, who specialise in large-scale colour work, in particular Thomas Ruff, Thomas Struth and Andreas Gursky.

In “Cruel and Tender”—a panoramic survey of 20th-century documentary photography at Tate Modern—Ms Dijkstra has asked three almost naked young women to pose for the camera soon after giving birth. Their tired faces reveal a mix of shock and triumph as they clutch their babies. On the opposite wall, she shows sweating Portuguese *toureiros* in ripped brocade jackets after a bullfight, before they have had time to wash the blood off their faces. In both instances the power of the images lies in capturing people in unguarded moments, just after they have been through a tense, dramatic and often exhilarating experience.

Because she likes shooting portraits in a series, Ms Dijkstra is occasionally likened to August Sander, the German photographer who became known for his early 20th-century portraits of his countrymen. Ms Dijkstra likes to watch people change. One fine example is the run of pictures she has taken of Almerisa, the daughter of Bosnian refugees living in Amsterdam. Taken at two-year intervals over almost a decade, the portraits show how the little girl—who was photographed first in a refugee centre dressed in her Bosnian Sunday best, her legs dangling from a red plastic chair—not only grows into a young woman, but makes the transition from eastern to western Europe.

In a portrait taken earlier this year, she catches the vulnerability behind Almerisa's make-up and knowing expression, bringing to mind what Diane Arbus, an American photographer, famously said about working in the “gap between intention and effect”. While Arbus took a cool look at people who were disabled or just plain eccentric, Ms Dijkstra's approach is both more subtle and more poignant.

Born in Holland, one of four children whose father ran the sales department of an electronics company, she trained as an art teacher, but discovered her real talent at De Moor, a photography centre in Amsterdam, in her spare time. Like August Sander, she started out as a commercial photographer, taking portraits for Dutch newspapers and company reports.

A turning point came in 1990, when Ms Djikstra was thrown from her bicycle by a car and laid up for five months. As she recovered, she made a self-portrait at the pool where she was exercising, which inspired a Dutch newspaper commissioned a series of beach portraits on the theme of summertime. Then, in 1992, armed with a grant that allowed her to explore her own work, she travelled to beaches in Europe and America in search of adolescents.

As large and perfectly composed as classical paintings, with only the sea and changing sky as background, the images convey what it is to be an awkward teenager—whether a well-fed 15-year-old from a rich resort in South Carolina in a glamour pose, or a fragile, reflective girl, halfway between

childhood and adolescence, on a chilly beach in Poland. Half a dozen years later, Ms Dijkstra's photograph of a boy on a beach in Odessa was shown next to Cézanne's “Male Bather” at the Museum of Modern Art in New York. Last year a set of six in the series sold at Christie's for $360,000.

A shy, sensitive woman who prefers to observe rather than ask questions, Ms Dijkstra has made a series of portraits of Olivier Silva, a 20-year-old from Toulouse who joined the French foreign legion three years ago—the culmination of a childhood dream. The service is gruelling, with punishment, sacrifice and redemption all part of the ritual of belonging. “I wanted someone young and malleable who then toughens—and to show the psychological, not just the physical changes.” With unusual clarity she does just that.

“Cruel and Tender” is at London's Tate Modern until September 7th

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About sponsorship

Bernard Williams

Jun 26th 2003
From The Economist print edition

The Guardian

Bernard Williams, critic of moral philosophy, died on June 10th, aged 73

WHEN talking of philosophy, Bernard Williams liked to drop in remarks that were not meant to be repeated. Here are some of them. Counselling a historian of philosophy to take the unusual step of eschewing all mention of Bishop Berkeley, he likened Berkeley to a drunken Irishman who reels into a pub insisting that "'tis all a load of rubbish about this 'matter' nonsense." Speaking of an implausible conference on the applications of Heidegger's philosophy, he described the attendees as "a bunch of Nazi orthodontists, goose-stepping across the rooftops". And discussing central-state materialism (a version of the idea that the mind is identical to the brain), he gleefully quoted an unnamed wit as saying that Australia was not just the place where this theory was invented, but also the only place where it is true.

Perhaps you had to be there, or at least know a fair bit of philosophical gossip. But colleagues were grateful for his vivid wit, because without it his brilliance would have been unendurable. To be bested invariably, refuted effortlessly, to be floored by answers to objections that you hadn't yet even thought of, was easier to bear when laughter was always just around the corner. After the rare distinction of a congratulatory first at Oxford, followed by a prize fellowship at All Souls', Professor Williams was dogged throughout his teaching career at London, Cambridge (where he was provost of King's College), Berkeley and Oxford again by the saying that he had been the cleverest undergraduate at Oxford, and still was.

The donnish barb was understandable, but quite wrong. Professor Williams made profound contributions to moral theory, most effectively in his critique of utilitarianism. He fatally undermined the idea that moral behaviour is a matter of dispassionately calculating the likely outcomes of alternative courses of action and plumping for whichever option stands to yield the greatest utility or happiness. News of utilitarianism's demise has, however, yet to reach all economists.

In "Utilitarianism: For and Against" (1973), Professor Williams showed how the theory depended on an impoverished idea of human action and motivation. By reducing people to little more than devices for the efficient production of desirable outcomes, utilitarianism ignores the value of integrity and the notions of personal responsibility and personal goals. Although it appears to provide a guide to life, it in fact robs human action of its point.

One traditional rival to utilitarianism in moral theory is Kantianism, but Professor Williams undermined that too, and with similar weapons. Kant sought to make morality as pure and disconnected as possible from the vagaries of circumstance and individual personality. Whether an action is right or wrong was to depend solely on the principle of action that lay behind it, and in particular on whether the agent could regard that principle as one that everyone ought to follow in all possible circumstances. Professor Williams ingeniously showed how hard it is for any such insular conception of morality to survive contact

with the messiness of real life. He coined the term “moral luck” to mark a fact that is incomprehensible to Kantians, but which—once he had highlighted it—came to seem undeniable: that whether or not a person's behaviour emerges as good or bad can sometimes depend on pure chance. Soldiers know that a man can become a hero partly by accident. The ancient tragedians knew that he could be undone by fate, which comes to much the same thing.

Ancient Greeks and fast cars

With the publication in 1993 of “Shame and Necessity”, a study of (among other things) the moral psychology of Greek tragedy, Professor Williams fulfilled the expectations of some of his first teachers, who saw his potential as a great classical scholar. Although some of his most discussed work was outside the field of ethics, it usually had some bearing on understanding humanity or human conduct. In an influential study of Descartes (1978), he introduced the notion of an “absolute conception of the world”, to mark the ambition of science to provide a picture of reality that is undistorted by any particular perspective. This he contrasted with the inescapably perspectival character of moral thinking. Yet he never managed to work out the extent to which objective truths of the sort to be found in science (which he firmly believed in, unlike some post-modernist thinkers) could also be found outside it. He wrestled with this question in his perhaps too subtle and discursive final book, “Truth and Truthfulness”. Reviewers, realising that it was the swan-song of a sick man, forbore to draw attention to its faults.

Away from his desk, his passion was music, especially opera. He served for nearly two decades on the board of the English National Opera. Another passion was speed; he did National Service flying Spitfires, and later enjoyed driving cars too fast. Always a man of the left, he had to wait for the return of a Labour government before he was awarded a knighthood, in 1999. He was involved with government committees and royal commissions on gambling, drugs, pornography and public (ie, private) schools. As this moral philosopher said, “I did all the major vices.”

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Overview

Jun 26th 2003
From The Economist print edition

America's Fed, in an attempt to fend off the twin threats of a sluggish economy and the risk of deflation, cut interest rates by a quarter-point to 1%, the lowest level since 1958. The Fed said that the American economy has "yet to exhibit sustainable growth" but also mentioned continued growth in productivity. One of the members of the Federal Reserve's open market committee, Robert Parry, voted to cut rates by even more, half a point, which some analysts saw as a sign of a sharp disagreement over how to respond to America's economic risks.

Stockmarkets cooled, as punters awaited the Fed's decision. The Dow Jones Industrial Average fell by 1.1%, though it remains up by 8% for the year.

America's housing market boomed in May, fuelled by low interest rates. Sales of new homes surged by 12.5% to 1.2m, a record high. Sales of existing houses posted a rise of 1.2%. Durable-goods orders fell by 0.3% in May, after a sharper fall in April. The current-account deficit hit a new record of $136 billion in the first quarter.

American consumer confidence in June, at 83.5 as measured by the Conference Board's index, was little changed from May's figure of 83.6. Forecasters had feared a bigger fall, after the University of Michigan's consumer- confidence index suffered a big and unexpected fall in the previous week. Consumers still have a rosier view of the next six months than they do of the present.

According to EuroCOIN, an indicator of economic activity published by Britain's Centre for Economic Policy Research, the **euro area's** economy continued to slow in May. **Germany's** IFO business-climate indicator rose in June, providing faint hopes of an increase in economic growth. German consumer-price inflation rose from 0.7% in the year to May to 1.0% in the year to June.

Wage growth in the **euro area** fell to 3.0% in the year to the first quarter from 3.3% in the year to the fourth quarter. In **Germany** wage growth fell from 3.7% in the year to March to 2.3% in the year to April. Earnings growth rose in **Spain**, however, climbing from 3.9% in the year to the fourth quarter to 4.9% in the year to the first quarter.

Swiss industrial production saw a reversal of fortune. Having fallen by 2.2% in the fourth quarter, it grew by 0.9% in the first quarter.

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Output, demand and jobs

Jun 26th 2003
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.9	Q1	+ 2.8	+ 3.0	+ 3.6	+ 2.3	Q4	+ 4.0	Q1	6.0	May	6.2
Austria	+ 1.3	Q4	– 0.5	+ 0.9	+ 1.6	– 1.5	Dec	+ 0.9	Dec	4.3	May	4.1
Belgium	+ 1.3	Q1	+ 0.6	+ 1.0	+ 2.0	+ 1.6	Apr	– 1.7	Mar	11.4	May†	10.4
Britain	+ 2.2	Q1	+ 0.3	+ 1.8	+ 2.5	– 1.8	Apr	+ 3.1	May	5.1	Apr††	5.2
Canada	+ 2.6	Q1	+ 2.4	+ 2.6	+ 3.1	+ 2.0	Mar	+ 2.3	Mar	7.8	May	7.7
Denmark	+ 1.2	Q1	+ 1.4	+ 1.4	+ 2.2	– 0.2	Apr	– 1.6	Apr	6.0	May	5.1
France	+ 1.0	Q1	+ 1.0	+ 1.0	+ 2.2	– 0.5	Apr	– 2.0	May	9.3	Apr	8.9
Germany	+ 0.2	Q1	– 0.9	+ 0.2	+ 1.4	– 0.5	Apr	+ 0.8	Apr	10.7	May§	9.7
Italy	+ 0.8	Q1	– 0.4	+ 0.9	+ 1.9	+ 1.7	Apr	– 1.6	Mar‡	8.8	Apr	9.0
Japan	+ 2.6	Q1	+ 0.6	+ 0.9	+ 0.9	+ 3.4	Apr	– 2.7	Apr	5.4	Apr	5.3
Netherlands	– 0.1	Q1	– 1.2	+ 0.2	+ 1.7	– 0.8	Apr	– 0.6	Mar	5.3	May**	3.8
Spain	+ 2.1	Q1	+ 2.0	+ 2.0	+ 2.7	– 4.2	Apr	+ 1.3	Mar	11.4	Apr	11.2
Sweden	+ 2.2	Q1	+ 2.4	+ 1.4	+ 2.3	+ 3.4	Apr	+ 4.9	Apr	4.2	May†	3.4
Switzerland	nil	Q1	– 1.0	+ 0.7	+ 1.7	+ 0.9	Q1	– 5.9	Mar	3.6	May†‡	na
United States	+ 2.1	Q1	+ 1.9	+ 2.2	+ 3.3	– 0.8	May	+ 4.9	Apr	6.1	May	5.8
Euro area	+ 0.8	Q1	nil	+ 0.8	+ 2.0	+ 0.8	Apr	– 1.6	Mar	8.8	Apr	8.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.2	Q1	– 4.9	na	na	– 2.3	Apr	+ 3.7	Mar	11.4	May†	11.9
Greece	+ 4.3	Q1	na	na	na	– 0.1	Apr	na		na		na
Iceland	+ 3.3	Q1	na	na	na	– 0.3	2002	na		3.6	May†	2.5
Ireland	+ 6.4	Q4	na	na	na	+ 3.7	Apr	+ 3.2	Apr	4.6	May	4.3
Luxembourg	+ 1.1	2002	na	na	na	+ 4.5	Mar	+ 4.6	Jan	3.6	Apr	2.7
New Zealand	+ 4.5	Q4	+ 3.4	na	na	+ 5.9	Q4	+ 6.4	Q1	5.0	Q1	5.3
Norway	+ 0.6	Q1	+ 1.3	na	na	–13.6	Apr	+ 4.5	Apr	4.4	Q1	4.1
Portugal	– 1.2	Q1	+ 0.3	na	na	– 3.1	Apr	+ 2.4	Apr	6.4	Q1†	4.5

*% change at an annual rate. †Not seasonally adjusted. ‡New series. ††Feb-Apr; claimant count rate 3.1% in May. §EU harmonised rate 9.4% in May. **Mar-May.

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Prices and wages

Jun 26th 2003
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 3.4	Q1	+ 2.9	+ 2.7	+ 2.5	+ 3.0	Q1	+ 0.5	+ 4.3	Q1	+ 4.1
Austria	+ 1.1	May	+ 1.9	+ 1.5	+ 1.3	+ 0.6	May	– 0.8	+ 2.2	Apr	+ 2.4
Belgium	+ 1.0	May	+ 1.3	+ 1.4	+ 1.3	– 0.4	May	– 0.2	+ 2.4	Q1	+ 3.1
Britain	+ 3.0	May	+ 1.1	+ 2.8	+ 2.4	+ 1.3	May	+ 0.1	+ 3.2	Apr	+ 3.3
Canada	+ 2.9	May	+ 1.0	+ 3.1	+ 2.1	– 0.1	Apr	– 1.1	+ 1.6	Mar	+ 3.2
Denmark	+ 2.2	May	+ 2.1	+ 2.4	+ 1.9	– 0.6	May	– 0.3	+ 3.9	Q1	+ 4.0
France	+ 1.8	May	+ 1.4	+ 1.8	+ 1.4	+ 0.7	May	– 1.2	+ 2.9	Q1	+ 4.0
Germany	+ 1.0	Jun	+ 1.0	+ 1.0	+ 0.9	– 0.2	May	– 1.3	+ 2.3	Apr	+ 2.4
Italy	+ 2.7	May	+ 2.3	+ 2.4	+ 1.9	+ 2.0	Apr	– 0.8	+ 1.7	Apr*	+ 2.3
Japan	– 0.1	Apr	– 1.1	– 0.5	– 0.5	– 1.0	May	– 2.2	+ 1.6	Apr	+ 0.4
Netherlands	+ 2.3	May	+ 3.3	+ 2.5	+ 2.1	+ 2.5	Apr	– 1.0	+ 2.7	Apr	+ 3.9
Spain	+ 2.7	May	+ 3.6	+ 3.0	+ 2.6	+ 0.7	May	+ 0.5	+ 4.9	Q1	+ 4.0
Sweden	+ 1.9	May	+ 2.0	+ 2.4	+ 1.8	– 1.4	May	– 0.2	+ 0.9	Mar	+ 4.7
Switzerland	+ 0.4	May	+ 0.6	+ 0.7	+ 0.9	– 0.5	May	– 1.3	+ 1.8	2002	+ 2.5
United States	+ 2.1	May	+ 1.2	+ 2.3	+ 1.7	+ 2.5	May	– 2.9	+ 3.2	May	+ 2.6
Euro area	+ 1.9	May	+ 2.0	+ 1.9	+ 1.5	+ 1.7	Apr	– 0.6	+ 3.0	Q1	+ 3.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.7	May	+ 1.4	na	na	– 1.3	May	– 1.8	+ 4.1	Q1	+ 3.2
Greece	+ 3.8	May	+ 3.4	na	na	+ 1.0	Apr	+ 3.7	na		na
Iceland	+ 1.8	Jun	+ 4.8	na	na	+ 3.2	Jul	+ 7.1	+ 5.6	May	+ 7.5
Ireland	+ 3.7	May	+ 4.7	na	na	– 7.5	Apr	+ 0.4	+ 6.8	Q4	+ 7.8
Luxembourg	+ 1.9	May	+ 1.9	na	na	+ 1.8	Apr	– 2.5	+ 3.1	Mar	– 1.2
New Zealand	+ 2.5	Q1	+ 2.6	na	na	– 1.3	Q1	+ 2.8	+ 2.3	Q1	+ 2.1
Norway	+ 2.1	May	+ 0.4	na	na	– 4.5	May	–11.3	+ 5.3	Q1	+ 4.6
Portugal	+ 3.7	May	+ 3.3	na	na	+ 1.1	May	+ 0.6	+ 1.1	Apr	+ 0.1

*New series.

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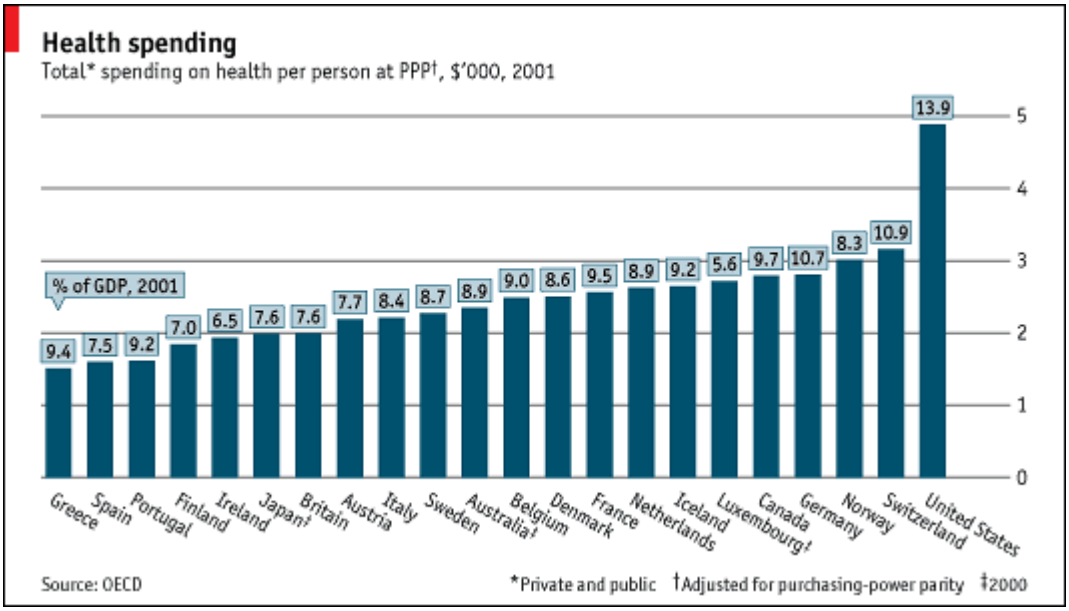
Health spending

Jun 26th 2003
From The Economist print edition



Spending on health care, private and public, is growing faster than GDP in most rich countries. America leads the way: in 2001, it devoted 13.9% of output to health care. That amounts to just under $5,000 per head. France spent half as much in dollar terms; but health care still absorbed 9.5% of French GDP, up from 8.6% in 1990. Britain, whose government aspires to match the European average, spent only 7.6% of GDP in 2001.

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Money and interest rates

Jun 26th 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jun 25th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 5.0	+10.8	Apr	4.62	5.05	4.09	4.73	5.87	5.52
Britain	+ 7.9	+ 8.3	May	3.63	4.06	3.21	4.06	4.94	5.67
Canada	+10.3	+ 7.1	May	3.03	2.70	3.05	4.42	5.36	6.15
Denmark	+ 7.4	+ 9.7	Apr	2.25	3.80	2.03	3.81	5.07	5.21
Japan	+ 4.8	+ 1.6	May	0.01	0.02	0.05	0.63	1.27	0.73
Sweden	+ 4.1	+ 4.5	Apr	2.71	4.24	2.74	4.07	5.30	3.19
Switzerland	+27.6	+10.6	May	0.28	1.22	-0.35	2.37	3.10	3.19
United States	+ 6.4	+ 6.6	May	0.88	1.74	1.26	3.35	4.70	5.27
Euro area†	+11.1	+ 8.7	Apr	2.15	3.43	1.98	3.61	4.83	3.63

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.46%, Japan No.250 0.63%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jun 26th 2003
From The Economist print edition

1995=100

	Jun 17th	Jun 24th*	% change on one month	% change on one year
Dollar index				
All items	76.9	76.6	– 0.6	+ 8.6
Food	77.4	76.7	– 3.1	+ 8.6
Industrials				
All	76.2	76.6	+ 3.0	+ 8.6
Nfa†	80.1	81.5	+ 7.3	+11.3
Metals	72.9	72.5	– 0.8	+ 6.1
Sterling index				
All items	71.8	72.6	– 2.0	– 2.2
Euro index				
All items	85.6	87.5	+ 2.4	– 8.5
Yen index				
All items	96.7	96.1	+ 0.2	+ 5.0
Gold				
$ per oz	363.25	347.55	– 6.2	+ 9.2
West Texas Intermediate				
$ per barrel	31.06	28.69	– 1.8	+ 9.1

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jun 26th 2003
From The Economist print edition

Market indices

	Jun 25th	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	3,031.9	3,077.0	2,673.3	- 0.8	-11.9	+ 1.9	+21.5
Austria (ATX)	1,300.1	1,325.7	1,120.2	- 0.5	-25.2	+13.0	+24.6
Belgium (Bel 20)	1,941.5	2,074.1	1,426.6	- 2.0	-47.3	- 4.1	+ 5.7
Britain (FTSE 100)	4,067.9	4,207.0	3,287.0	- 3.3	-41.3	+ 3.2	+ 7.4
Canada (Toronto Composite)	6,970.6	7,121.0	6,228.6	- 1.9	-38.8	+ 5.4	+23.9
Denmark (KBX)	185.2	188.8	145.0	- 1.6	-38.6	+11.4	+22.8
France (SBF 250)	2,089.8	2,154.5	1,630.1	- 3.0	-52.4	+ 1.8	+12.2
(CAC 40)	3,108.7	3,213.9	2,403.0	- 3.3	-55.1	+ 1.5	+11.8
Germany (DAX)	3,198.8	3,304.2	2,203.0	- 3.2	-60.3	+10.6	+21.9
Italy (BCI)	1,171.7	1,195.9	959.4	- 2.0	-46.3	+ 7.3	+18.3
Japan (Nikkei 225)	8,932.3	9,137.1	7,607.9	- 1.8	-77.0	+ 4.1	+ 5.1
(Topix)	884.5	904.3	770.6	- 1.0	-69.3	+ 4.9	+ 5.9
Netherlands (AEX)	294.5	337.3	218.4	- 3.9	-58.0	- 8.8	+ 0.6
Spain (Madrid SE)	724.9	737.3	576.8	- 0.9	-36.8	+14.3	+26.0
Sweden (Affarsvarlden Gen)	154.1	158.6	127.8	- 2.8	-61.5	+ 6.1	+16.6
Switzerland (Swiss Market)	4,832.1	4,992.5	3,675.4	- 3.2	-42.6	+ 4.3	+ 8.7
United States (DJIA)	9,011.5	9,323.0	7,524.1	- 3.0	-23.1	+ 8.0	+ 8.0
(S&P 500)	975.3	1,011.7	800.7	- 3.4	-36.1	+10.9	+10.9
(NASDAQ Comp)	1,602.7	1,677.1	1,271.5	- 4.4	-68.3	+20.0	+20.0
Europe (FTSE Eurotop 300)*	859.9	890.8	682.7	- 2.7	-49.6	+ 0.3	+10.6
Euro area (FTSE Ebloc 100)*	736.7	758.6	565.7	- 2.9	-52.5	+ 2.5	+13.0
World (MSCI)†	876.5	907.3	710.8	- 3.2	-39.5	na	+10.6
World bond market (Citigroup)‡	572.4	583.9	518.6	- 0.3	- 2.0	na	+ 9.0

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jun 26th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account % of GDP, forecast 2003	Current account % of GDP, forecast 2004	Exchange rate trade-weighted† 1990=100 Jun 25th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Jun 25th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2003‡
Australia	− 9.0 Apr	− 20.8 Q1	− 4.3	− 3.6	83.5	74.8	1.49	1.78	2.49	1.72	1.27	0.2
Austria	+ 0.7 Mar	+ 1.7 Apr	− 0.1	− 0.3	102.3§	100.1	0.86	1.01	1.45	−	0.74	-1.3
Belgium	+ 17.3 Apr	+ 11.1 Feb	+ 4.9	+ 5.0	102.2§	98.9	0.86	1.01	1.45	−	0.74	nil
Britain	− 56.8 Apr	− 13.1 Q4	− 1.6	− 1.5	101.1	103.5	0.60	0.66	−	0.69	0.51	-1.9
Canada	+ 36.2 Apr	+ 13.9 Q1	+ 1.6	+ 1.5	86.8	78.1	1.34	1.52	2.25	1.55	1.14	1.1
Denmark	+ 9.2 Apr	+ 5.7 Apr	+ 2.4	+ 2.4	106.5	103.3	6.42	7.50	10.7	7.43	5.46	1.6
France	+ 7.4 Apr	+ 25.3 Apr	+ 1.7	+ 1.5	105.5§	101.5	0.86	1.01	1.45	−	0.74	-3.6
Germany	+124.7 Apr	+ 48.6 Apr	+ 2.0	+ 1.6	102.8§	98.4	0.86	1.01	1.45	−	0.74	-3.7
Italy	+ 5.4 Apr	− 11.5 Mar	− 0.4	− 0.3	75.2§	72.4	0.86	1.01	1.45	−	0.74	-2.4
Japan	+ 95.4 Apr	+111.7 Apr	+ 2.5	+ 2.6	128.5	135.5	118	119	197	136	−	-7.7
Netherlands	+ 29.5 Apr	+ 2.9 Q1	+ 2.9	+ 3.1	101.6§	97.8	0.86	1.01	1.45	−	0.74	-1.6
Spain	− 44.4 Apr	− 19.8 Mar	− 2.2	− 2.2	76.6§	74.2	0.86	1.01	1.45	−	0.74	-0.4
Sweden	+ 15.7 May	+ 11.5 Q1	+ 3.6	+ 3.6	80.6	77.8	7.93	9.20	13.3	9.17	6.75	0.7
Switzerland	+ 5.5 May	+ 32.0 Q4	+11.7	+11.7	112.7	114.3	1.33	1.48	2.22	1.54	1.13	na
United States	−519.7 Apr	−510.2 Q1	− 5.3	− 5.4	101.9	112.3	−	−	1.67	1.16	0.85	-4.6
Euro area	+ 86.8 Apr	+ 48.0 Mar	+ 0.7	+ 0.6	90.1	82.4	0.86	1.01	1.45	−	0.74	-2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.4 Apr	+ 9.3 Apr	na	na	81.1§	77.9	0.86	1.01	1.44	−	0.73	3.1
Greece	− 23.0 Apr	− 11.0 Apr	na	na	59.1§	57.5	0.86	1.01	1.44	−	0.73	-1.0
Iceland	+ 0.1 Apr	nil Q1	na	na	97.7**	86.9	76.1	87.7	127	88.0	64.8	nil
Ireland	+ 36.2 Mar	− 0.2 Q4	na	na	93.4§	87.0	0.86	1.01	1.44	−	0.73	-0.8
Luxembourg	− 3.1 Feb	+ 1.7 Q4	na	na	102.2§	98.9	0.86	1.01	1.44	−	0.73	0.2
New Zealand	− 0.9 Apr	− 1.4 Q1	na	na	98.6	87.8	1.70	2.06	2.85	1.97	1.45	0.8
Norway	+ 27.8 May	+ 26.9 Apr	na	na	97.1	105.3	7.15	7.46	12.0	8.27	6.08	11.3
Portugal	− 12.5 Mar	− 8.1 Mar	na	na	92.5**	89.9	0.86	1.01	1.44	−	0.73	-3.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, April average. ‡OECD forecast. **IMF, February average.

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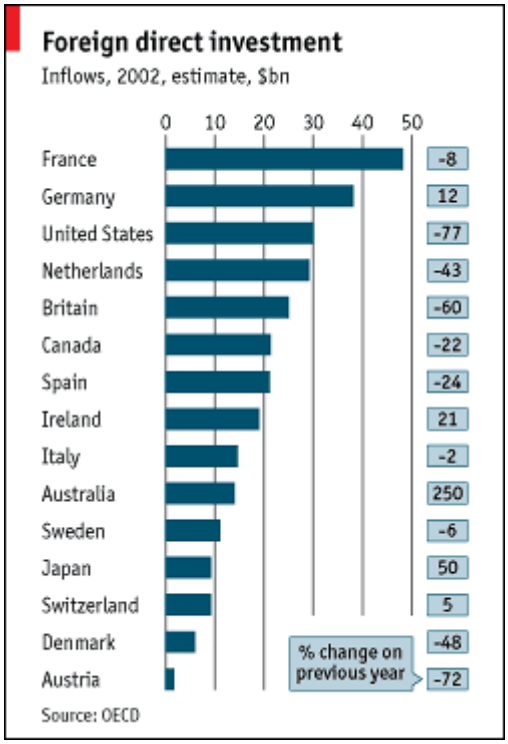
Foreign direct investment

Jun 26th 2003
From The Economist print edition



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Overview

Jun 26th 2003
From The Economist print edition

Brazil's current-account surplus hit $882m in May, the biggest since 1994. In the 12 months to May, the current-account deficit shrank to $600m.

Hong Kong's deflation was 2.5% in the year to May. Industrial production fell by 8.8% in the year to the first quarter.

Poland's GDP grew by 2.2% in the year to the first quarter.

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Economy

Jun 26th 2003
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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q1	+13.7	May	+ 0.7	May	+22.2	May	+35.4	2002	320.9	Mar
Hong Kong	+ 4.5	Q1	– 8.8	Q1	– 2.5	May	– 8.0	Apr	+18.4	Q1	116.1	May
India	+ 2.6	Q4	+ 4.9	Apr	+ 5.1	Apr	–10.1	Apr	+ 4.8	Q4	77.9	May
Indonesia	+ 3.4	Q1	+18.4	Mar	+ 6.9	May	+25.5	Apr	+ 7.5	Q4	32.6	Apr
Malaysia	+ 4.0	Q1	+11.8	Apr	+ 1.0	May	+15.6	Apr	+ 7.3	Q4	34.4	Apr
Philippines	+ 4.5	Q1	+ 7.3	Mar	+ 2.7	May	– 0.1	Apr	+ 2.9	Mar	12.7	May
Singapore	+ 1.6	Q1	– 5.0	Apr	– 0.1	May	+11.5	Apr	+21.3	Q1	85.8	May
South Korea	+ 3.7	Q1	+ 1.8	Apr	+ 3.2	May	+ 7.6	May	+ 2.6	Apr	128.3	May
Taiwan	+ 3.2	Q1	– 2.8	May	+ 0.3	May	+16.7	May	+25.9	Q1	175.2	May
Thailand	+ 6.7	Q1	+16.2	Apr	+ 1.9	May	+ 4.3	Apr	+ 8.6	Apr	38.0	May
Argentina	+ 5.4	Q1	+12.2	May	+14.3	May	+16.8	Apr	+ 8.9	Q4	11.4	May
Brazil	+ 2.0	Q1	– 4.2	Apr	+17.2	May	+19.3	May	– 0.6	May	41.5	Apr
Chile	+ 3.5	Q1	+ 0.6	Apr	+ 3.5	May	+ 2.4	May	– 0.6	Q1	15.9	May
Colombia	+ 3.8	Q1	+15.3	Mar	+ 7.7	May	– 0.4	Feb	– 1.6	Q4	10.6	May
Mexico	+ 2.3	Q1	– 4.8	Apr	+ 4.7	May	– 6.6	May	–12.7	Q1	53.6	May
Peru	+ 2.5	Apr	– 0.5	Apr	+ 2.4	May	+ 0.4	Apr	– 1.1	Q1	9.7	May
Venezuela	–29.0	Q1	–14.7	Mar	+35.0	May	+15.0	Q1	+ 9.5	Q1	9.9	Mar
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 3.6	Mar	– 7.4	Jan	+ 1.0	Q1	13.1	Feb
Israel	+ 0.3	Q1	– 2.4	Apr	+ 1.6	May	– 5.6	May	– 0.5	Q1	23.7	May
South Africa	+ 2.5	Q1	– 4.9	Apr	+ 7.8	May	+ 3.3	Apr	– 0.2	Q1	6.0	Apr
Turkey	+11.4	Q4	+ 4.2	Apr	+30.7	May	–16.9	Apr	– 3.3	Apr	28.6	May
Czech Republic	+ 2.2	Q1	+ 5.6	Apr	nil	May	– 2.3	May	– 4.4	Q1	26.1	May
Hungary	+ 2.7	Q1	+ 6.8	Apr	+ 3.6	May	– 2.8	Apr‡	– 3.6	Apr	10.9	May
Poland	+ 2.2	Q1	+11.7	May	+ 0.4	May	–10.0	Apr	– 5.5	Apr	29.9	Apr
Russia	+ 5.2	Q4	+ 8.5	May	+13.6	May	+52.1	Apr	+38.3	Q1	61.1	May
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.6	2002†	+15.8	Nov	+ 2.6	May	– 1.2	May	+ 2.6	2002†	9.7	Apr
Saudi Arabia	+ 0.7	2002§	na		– 1.4	Mar	+38.6	2002§	+11.7	2002	23.1	Apr

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series. §Economist Intelligence Unit estimate.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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Financial markets

Jun 26th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jun 25th		Dec 31st 2002	
	Jun 25th	year ago	Jun 25th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.9	na	1,572.6	-3.4	+ 10.8	+ 10.8
Hong Kong	7.80	7.80	13.1	1.02	9,629.0	-3.4	+ 3.3	+ 3.3
India	46.5	48.9	77.9	4.98	3,517.3	+2.5	+ 4.1	+ 7.3
Indonesia	8,223	8,625	13,766	10.13	500.3	-0.6	+ 17.7	+ 28.1
Malaysia	3.80	3.80	6.36	3.10	682.3	-0.2	+ 5.6	+ 5.6
Philippines	53.3	50.2	89.2	7.94	1,231.6	-1.7	+ 20.9	+ 21.2
Singapore	1.74	1.79	2.91	0.56	1,462.6	-1.6	+ 9.1	+ 8.8
South Korea	1,187	1,220	1,987	4.28	674.0	-0.3	+ 7.4	+ 7.3
Taiwan	34.5	34.0	57.8	1.25	4,933.8	-1.3	+ 10.8	+ 11.7
Thailand	41.5	42.1	69.4	1.75	453.9	+1.7	+ 27.3	+ 32.3
Argentina	2.76	3.54	4.62	12.94	792.6	+2.8	+ 51.0	+ 84.2
Brazil	2.85	2.70	4.78	25.76	13,025.7	-3.6	+ 15.6	+ 43.4
Chile	704	676	1,178	2.76	5,962.3	-2.5	+ 18.8	+ 21.5
Colombia	2,808	2,393	4,700	7.77	2,087.9	+2.8	+ 29.8	+ 32.5
Mexico	10.46	6.69	17.5	5.11	7,078.4	-0.7	+ 15.5	+ 15.5
Peru	3.48	3.47	5.82	3.75	1,830.3	-0.2	+ 31.5	+ 32.9
Venezuela	1,598	1,236	2,675	17.15	14,207.1	+4.9	+ 77.3	+ 53.8
Egypt	5.99	4.60	10.02	10.16	8,349.0	+2.1	+ 55.4	+ 20.2
Israel	4.36	4.96	7.29	5.09	442.5	-0.7	+ 33.1	+ 45.1
South Africa	7.7	10.2	12.9	11.70	8,452.8	-4.7	- 8.9	+ 1.7
Turkey	1,435,500	1,545,000	2,403,171	37.00	10,740.2	-3.3	+ 3.6	+ 19.8
Czech Republic	27.2	31.9	45.5	2.31	532.4	-0.1	+ 15.6	+ 27.8
Hungary	226	254	378	9.03	7,880.2	+0.6	+ 1.1	+ 0.6
Poland	3.87	4.02	6.48	5.35	15,937.8	+0.5	+ 10.9	+ 10.0
Russia	30.3	31.5	50.8	16.00	502.1‡	+1.6	+ 32.8	+ 39.8
EMF (MSCI)*	1.00	1.00	1.67	na	332.7	-0.9	na	+ 13.9
EMBI+†	1.00	1.00	1.67	na	277.5	-1.1	na	+ 21.2

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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